

May 2018

Sell in May ... and go away?



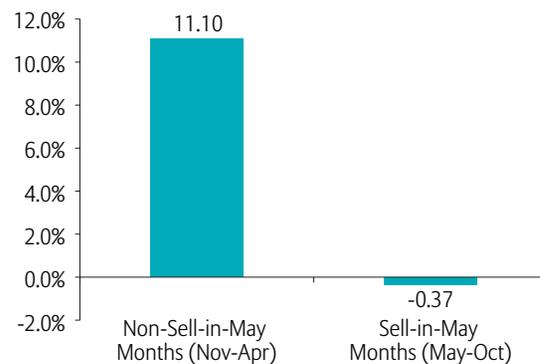
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With rising interest rates, slowing global growth, and geopolitical tensions emerging from Iran, North Korea and China, investors may be tempted to adhere to the old trading adage “sell in May and go away.” But is this the right strategy for 2018?

Past returns have paled

Historically there is precedent to support the sell-in-May strategy known to influence investors. Since 1971, 70% of returns for the S&P 500 Index for the seasonal May-to-October period have been anemic, -0.37% versus 11.1% in the remaining six months of the year. (See *Chart 1*.)

Chart 1: Sell-in-May months are often spiritless
Average return pattern for the S&P 500 Index (1971-2017)



Source: Factset (1971-2017). 70% of years where sell-in-May in effect. Past performance is not indicative of future results.

Sell-in-May months may shine

However, investors who generally follow seasonal patterns should think twice this year: markets have already experienced high volatility in the first quarter, and the S&P 500 Index ended the period slightly

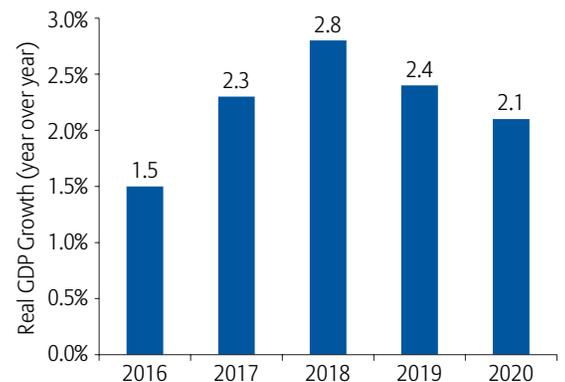
down (-1.2%). Our analysis shows that there have been eight instances since 1990 where the first quarter of the year had negative average monthly returns for the S&P 500 Index.

What has happened subsequent to a weak first quarter for the sell-in-May periods? Well, in five of the eight instances, the S&P 500 Index returned positive average monthly results in the May-to-October time frame. And the three periods that had negative returns were during recessions (1990, 2001 and 2008). Thus, given the negative first three months of the year, the data seem to be more in favor of an accommodative six months ahead – good news for investors.

2018 could be a peak year

More broadly, our view remains that a recession in the US in the next 12 months is unlikely. From an economic and earnings perspective, we continue to see potential peak years, with the S&P 500 Index earnings growth on track for 18%-20% in 2018, and real GDP growth forecast to approach 2.8%. (See *Chart 2*.)

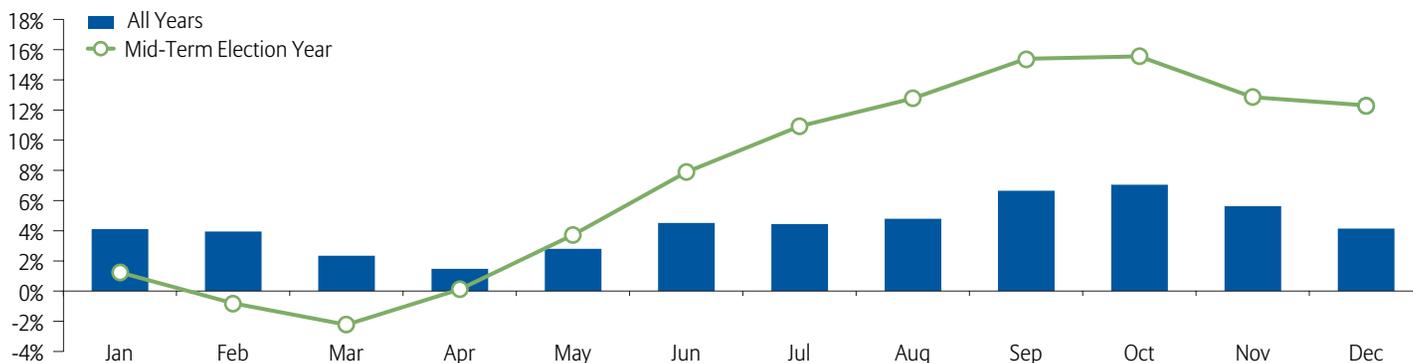
Chart 2: Despite a hard start, the year is looking up
Consensus GDP growth points to 2018 as a peak year



Source: Bloomberg Consensus. As of April 2018.

Chart 3: Elections can lift the veil of market uncertainty

S&P 500 Index performance during mid-term election years



Source: Bloomberg. Calculations are for 6-month periods following the date, January 1950 to April 2017. Past performance is not indicative of future results.

And while 10-year Treasury yields hover around 3.0%, we have also seen more recently inflation and wage growth that are softer than expectations. This sets us up for a supportive market environment for the remainder of the year. US markets will likely have to climb the walls of worry around slowing global growth, and rising tension around Iran, North Korea and China.

Furthermore, mid-term election years, while certainly causing some volatility prior to November, tend to end on a strong note, as some uncertainty is removed from the marketplace. (See Chart 3.)

Five to watch

Going forward, we continue to see key themes powering markets:

1 Growth positioned to outperform: This year we have seen growth continue to outperform value, with technology and consumer discretionary stocks showing leadership, despite bouts of volatility. In a late-cycle, potentially inflationary environment, this trend may continue. Our conviction lies with the long-term theme of “winners from disruption,” particularly in the technology and retail space.

2 Value may have its moment: We do believe at some point over this cycle certain value sectors will show signs of market leadership; this can happen swiftly and investors should be positioned accordingly. We have already seen the energy sector show strength, given the sharp rise in oil prices; we also believe financials and certain industrial sectors can do well in this environment benefiting from

tailwinds. It remains early yet for a rotation into highly defensive sectors such as consumer staples and utilities as signs of recession in the US remain muted.

3 Small cap’s comeback: With rising trade tensions and uncertainty around global growth, it is interesting to see small-cap companies, which tend to be domestically oriented, making a comeback. The small caps have outperformed large caps by 2.2% and are prime candidates for active fundamental investors. (The S&P Small Cap 600 Index is up 1.2% year-to-date as of April 30, 2018, while the S&P 500 Index returned -1.0% over the same period.)

4 High yield is a bright spot: Within fixed income, we continue to favor shorter duration strategies, and given we do not see a rise in defaults on the horizon, higher yielding fixed income continues to remain attractive.

5 Stay diversified and somewhat defensive: Rather than “sell in May and go away,” perhaps the adage should be “diversify in May and sleep better at night.” Remaining diversified, not only by asset class and sector, but also with some exposure to commodities, makes sense particularly in a later cycle market with shifting market leadership. As noted above, while we don’t see a turn in the cycle in the next 12 months, as we get later in the cycle, adding alternative assets to a portfolio such as private credit, infrastructure and real estate may make sense.

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