Stock Market Review

Sell in May and go away?

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A well-known investment saying used by many international commentators is "sell in May and go away". The month of May is generally regarded as a good time to sell because it usually marks the start of what historically has been the worst six-month period (May-October) for global equity markets.

In recent years, investors who followed this principle have fared well as equity markets generally performed negatively during the summer months. One of the best examples of this scenario is 2008 as the bear market started during the summer. After a relatively calm period in May 2008, the main international equity markets all tumbled well over 30 per cent between June and October!

Summer 2009 was the start of the current bull market so it was not a good time to sell equities. However, adopting the "sell in May" strategy in 2010 would have rewarded investors due to the volatile conditions that year. Likewise, in 2011, equity markets had some troubled times as Europe's sovereign debt crisis took centre stage and the "sell in May" strategy would have been prudent to follow.

Initially, this principle seemed to also have been worthwhile following in 2012 as global equity markets performed negatively during the month of May. However, markets rallied during the summer months with the S&P 500 rising by more than 13 per cent between late May and the end of September last year following comments by the Governor of the European Central Bank that they would do "whatever it takes" to save the euro together with the renewed money printing by the US Federal Reserve and the Bank of England.

Recent years therefore indicate that it would generally have been advisable to follow the "sell in May" strategy. However, was it a good guideline to follow this year as well? The performance of global equity markets last month clearly shows that it would not have been the ideal thing to do as markets maintained their upward trend in May. Most global equity markets touched all-time highs or multi-year highs during the final two weeks of May.

One of the best performing global equity markets last month was Germany's DAX with a rise of 5.5 per cent followed by the Nasdaq in the US with a 3.8 per cent gain. The other US benchmark indices also performed positively with gains of 1.9 per cent for the Dow Jones Industrial Average and 2.1 per cent for the S&P 500. The FTSE 100 in the UK and France's CAC40 both gained 2.4 per cent each.

However, the month-on-month performances do not depict the entire story behind the developments across international financial markets during May. While indices generally surged ahead for most days until the third week of May, most markets were volatile and gave back some gains in the final days of the month. The Dow Jones in the US which performed positively for the past seven consecutive months (the first time since the bull market began in 2009), closed lower in two of the last three days of May after the Dow Jones hit a fresh record closing high of 15,409.39 points on May 28. Similarly, the FTSE 100 in the UK shed 3.8 per cent after touching a multi-year high of 6,873.75 points on May 22.

It is worth highlighting that despite the evident weakness and volatility towards the end of last month, some of the major equity markets are having their strongest year since 1999. The Dow Jones has risen by over 15 per cent in the first five months of 2013 with the S&P 500, the Nasdaq and the FTSE 100 also showing double-digit returns.

The recent change in sentiment came about following comments made by the US Federal Reserve that it could start reducing its monetary stimulus measures (its quantitative-easing bond buying) earlier than expected. Investors fear that equity markets will suffer a correction once the Federal Reserve reduces the pace of asset purchases in the near future.

However, many commentators feel that the Federal Reserve will not slow its bond purchases before early 2014 since the economy is still growing at a slow pace and the job market has yet to pick up enough steam to reduce the unemployment rate. The Fed had indicated some months ago that it would not start raising short-term interest rates until the jobless figure falls towards 6.5 per cent compared to the recent rate of unemployment of 7.5 per cent.

The warnings from some Fed officials of a slowdown in stimulus measures and signs of an uptick in the economy eventually leading to tighter monetary policy also had a sizeable negative impact on the bond market. Sovereign bond prices of the generally-regarded "safe havens", i.e. US treasuries, German bunds and UK gilts, declined rapidly in May with some analysts claiming that this is an indication of an end to the 30-year bull market for bonds.

The 10-year US Treasury yield climbed by more than 45 basis points during May with a corresponding decline in the price of the bond thereby wiping out the year-to-date gains accumulated during the previous four months. The decline in the price of US treasuries represented the worst monthly loss since December 2010. On May 31, the yield on the 10-year US Treasury paper climbed to a high of 2.21 per cent (its highest level since April 2012). Likewise, the eurozone benchmark indicator (i.e. the 10-year German bund) saw the yield rise to a high of 1.577 per cent (on June 3) corresponding to a 3.5 per cent decline in the bond price from its 9-month high reached in early May 2013 with yields at 1.16 per cent.

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The bond market is also seeing signs of fatigue which could be another factor impacting investor sentiment since a premature rise in rates having significant consequences for the fixed-income market could slow the economic recovery and housing rebound.

Another factor which also added to the nervous sentiment across the international financial markets in recent weeks was the sharp decline in the Japanese equity market. The Nikkei has surged by over 30 per cent this year but dropped to a five-week low at the end of May. The index is in 'correction territory' after shedding 14 per cent since its 'intraday' peak of May 22. The heavy selling which commenced with a 7.3 per cent decline on May 23 (the worst daily loss in more than two years) alarmed many investors and is largely due to fears that the aggressive steps being taken by the Japanese Government to stimulate the failing economy may prove unsuccessful.

While the performance among global equity markets has generally been positive during the month of May, this does not mean that June or the other summer months is also going to be a good time for investors. In fact, statistics indicate that June is the worst-performing month for the Dow over the past 20 years.

Many international commentators list various reasons that could cause the rally to stall and markets to experience a correction. The health of the Chinese economy is one of the factors that could fuel the downturn. There are major concerns about the health of China's banks and the slower economic growth from the world's second largest economy could be critical for a number of other major economies including Japan and Australia.

The eurozone is another reason that could add to investor worries. Although the Cypriot bailout was agreed to and the ECB reduced interest rates to boost confidence, the eurozone economy remains in deep recession and a number of countries including Spain and Slovenia could trigger the next crisis.

Moreover, it is widely argued that prolonged periods of money printing tend to create market distortions and the consequences of a slower pace of stimulus measures could send shock waves across the markets.

The developments over recent weeks which showed increased nervousness in both the equity and the bond markets clearly indicate that over the coming months a period of extended volatility is likely for investors.