"SELL IN MAY" STRATEGY

TELLS YOU EXACTLY WHEN TO GET OUT

"Sell in May" Strategy Tells You Exactly When to Get Out

By Michael Carr

AS you know, May 1 comes around every year, and with it comes the popular saying "Sell in May and go away."

It's one of the most famous sayings on Wall Street. A Google search for the phrase returns over 2.4 billion results:

Historically, the best returns come between November and April. And many of the worst market crashes have occurred in September and October. They are part of the worst six months that begin in May.

That's why many interpret the phrase to mean that you should consider taking a summer vacation because you won't miss big gains in the market

However, if you're selling exactly on May 1, you may be leaving big profits on the table.

Rather than sell on May 1, *I have found a specific trading signal that tells you exactly which day to get out.*

So, let's get right to it…

Why May to October Brings the 6 Worst Months

First, let's revisit the origins and meaning of the phrase.

According to market historians, the saying dates back to at least the 19th century and originated in England. The London Stock Exchange was among the world's most important markets at that time. But the city of London wasn't always the most pleasant place to be.

It was the beginning of the industrial revolution, and cities were facing new problems. London was crowded and getting worse. The mass of people in cramped living spaces created new problems as people create waste that needed to be disposed of.

But people weren't the only source of waste. Newly built factories contributed and so did the horses that were a primary source of transportation.

Much of that waste ended up in the Thames River.

By the 1800s, the river made summers memorable. The smell from the waste dumped into the river combined with heat and humidity to make London unpleasant. One of the hottest summers in history occurred in 1858, a year that became known as the Great Stink in London.

Successful traders and financiers of that time would often buy country homes. This would allow them to leave the city as the heat set in, starting in about May. At that time, traders started saying: “Sell in May and go away, do not return until St. Leger's Day.”

St. Leger’s Day is an annual horse race that’s still held in late September in England. The first race was in September 1776 and was organized by Anthony St. Leger. In time, this race became the unofficial end of summer, much like Labor Day is in the U.S. today. It would take some time for everyone to get back to work, but by the end of October, activity would resume to the usual pace.

That’s the origin of “sell in May” and the reason why the period from May through October is considered to be the worst six months.

Jumping back to our current times, now let’s look at how this idea works on the S&P 500 today.

Tests Confirm “Sell in May” Still Works Today

“Sell in May” can be programmed and tested. What we learn is that investing in the S&P 500 Index between November 1 and April 30 each year, and then switching into cash for the other six months, shows an average return of 6.1% since 1933.

That compares with an average return of 3.5% in the worst six months of the year, the period that begins in May.

The win rate is slightly better with the S&P 500 delivering a gain 74.2% of the time in the best six months compared to 66.7% of years during the worst six months.

Now, I started the test in 1933 because that’s when the 20th amendment to the Constitution moved the President’s inauguration from March to January. Strong seasonal trends in the stock market are tied to Presidential elections, and data before 1933 shows different patterns.

We happen to have a large amount of history for the S&P 500, but, we can also test this idea on the Nasdaq 100 Index going back to 1985.

The Nasdaq measures technology stocks. Here, the best six months have an average gain of 11.6% and a win rate of 77.8%. In the worst six months of the year, we see an average gain of 6.6% and 72.2% of the years since 1985 show gains in that time.

And it’s not just the U.S.

Vacations Lead to Less Market Activity

This market anomaly has been studied in 114 different markets around the world, and it is present in 87 countries (76% of the markets). “Sell in May” works in countries in every type of political environment and climate.

Researchers have looked for reasons. They have assessed differences in the weather, the possible impact of seasonal affective disorder and a variety of other potential causes.

The most likely cause seems to be that people around the world take vacations during the worst six months, and that leads to less activity in the stock markets.

Vacation activity is the original reason behind the saying as we talked about last week. Now, researchers have confirmed that traders are more risk averse during the summer and fall and there appears to be less liquidity in the markets during those months.

It's interesting to see how wisdom generated hundreds of years ago stands up to strict statistical scrutiny today.

Next, I'll cover the performance of the "Sell in May" strategy on four specific exchange-traded funds (ETFs).

Strategy Results on SPY, DIA, IWM and QQQ

Let's start by looking at the following chart, which shows the percentage of times that four ETFs showed a gain during the six-month periods over the past 20 years. The average percent gain is also shown below:

In their full names, the four ETFs included here are:

	Best Six Months		Worst Six Months	
	Win Rate	% Gain	Win Rate	% Gain
SPY	85%	7.5%	85%	4.5%
DIA	85%	7.2%	85%	4.2%
IWM	80%	8.7%	70%	4.0%
QQQ	80%	8.4%	80%	8.9%

- SPDR S&P 500 ETF Trust (SPY)
- SPDR Dow Jones Industrial Average ETF Trust (DIA)
- iShares Russell 2000 ETF (IWM)
- Invesco QQQ Trust (QQQ)

Each one tracks a major index, and these are the among the most popular ETFs in the market.

Now, one thing that jumps out from that chart is that the worst six months aren't very bad. The ETFs are almost always up during that time. However, the gains are about 40% lower for SPY and DIA.

IWM's average return in the worst six months is 54% lower than in its best six months. On the other hand, QQQ performs a bit better in the worst six months than in the best six months.

Enhancing "Sell in May" for Better Results

All that said, applying the basic "Sell in May" approach to these doesn't really make for trades worth our time. I'll explain how we can improve this strategy for better results shortly.

You see that we make money in the worst six months which is the goal of investing. Of course, you might say that you'd rather have the high returns in the best six months.

However, by missing the gains in the worst six months, your total return will be less than a simple 'buy and hold' strategy.

Naively following the "Sell in May and go away" rule will result in more work for lower returns. In other words, that hurts investors in the long run.

Two years provide an example of how selling in May can lead to missed opportunities.

In 2009, the S&P 500 Index gained 19% in the worst six months. In 2020, the strategy missed a 17% gain.

Failing to participate in those rallies has serious consequences. It could mean that your retirement account won't be fully funded when you plan to retire. That would mean you have to work a few more years.

When I managed money, I met many people who had lost money in the 2008 bear market and needed to work for a few more years. They were unhappy and reasonably so. That's why I believe it's important to avoid strategies that are designed to miss major bull market moves like Sell in May..

Apply This Simple Indicator to the "Sell in May" Strategy

We can improve the "Sell in May" strategy by adding a moving average. With this approach, we will sell in May only if prices are below the 200-day moving average (MA).

The 200-day MA is used to define the direction of the long-term trend. When the price is above that MA, the trend is up. We define a downtrend as times when the price is below the MA.

Now, rather than selling in May, we want to hold our position as long as the ETF remains in its long-term uptrend. The results for this approach are shown in the table below. As you can see, there's improvement in returns for every ETF.

	Worst Six Months	
	Win Rate	% Gain
SPY	95%	7.2%
DIA	90%	5.9%
IWM	70%	4.7%
QQQ	85%	9.4%

In addition, the long-term uptrend is easy to follow since you can find the 200-day MA on almost any website that offers stocks charts.

Obviously, past results are not indicative of future performance. But to help you get a better idea of this indicator at work, let's look at a past example of how following the 200-day MA on QQQ would improve our results with the "Sell in May" rule.

The chart below shows the price action of QQQ from March to December of 2020. In May 2020, the prices stayed above the 200-day MA, and the trend was up.

Choosing to hold QQQ rather than selling in May would have delivered double-digit gains for the position in the worst six months of the year. Applying this simple indicator can help us capture what would otherwise be missed profits that come with extended uptrends.

I used the 200-day MA because this is a long-term strategy. We are looking at a holding period of up to six months. Using a shorter-term MA creates more trading activity and doesn't generally improve the results.

The same is true for applying momentum indicators. You could sell in May when an indicator like MACD turns bearish. This should be done on a weekly chart since the daily chart will give signals that take you out of the long-term trend whenever the ETF pulls back a few percent.

While MACD or other momentum indicators can be useful, they aren't consistent with this strategy.

This is a long-term strategy, so you should follow long-term indicators like the 200-day MA. When using this tool, many years you won't get a sell signal.

But when you do, you're likely to miss some of the deepest bear markets like the one we had in 2020 or 2008 — and avoiding bear markets can lead to large gains in wealth.

Regards,

Michael Carr
Editor, *Precision Profits*

Money and Markets
P.O. Box 8378
Delray Beach, FL 33482 USA
USA Toll Free Tel.: (866) 584-4096

Email: http://moneyandmarkets.com/contact-us

Website: www.moneyandmarkets.com