Sell in May?

The old adage “sell in May, go away, and come back in November” still gets its share of use. The general meaning is that stock market performance has been better during the November-April period than during the summer months of May-October, so go to cash, enjoy your vacation, and reinvest later. There were years when this has played out well, and years when you were sorry if you followed it as a rule. Perhaps the transition from the vision of brokers leaving their phones to go to the beach decades ago to computer-driven investment models has something to do with why the adage is tougher to follow now than years ago. Or perhaps it was just a silly saying to begin with. At any rate, the recent stock market weakness has some investors wondering if the adage may still hold.

Most major stock and bond market indices are in the red this year, as of May 19th[[1]](#endnote-1):

S&P 500 -17.7%

Nasdaq -27.0%

Russell 2000 Small Cap -20.9%

MSCI EAFE International -15.2%

Barclays Aggregate Bond -9.6%

While inflationary concerns rule the headlines, the reality is that much of the weakness in stocks is not related to earnings as much it can be attributed to valuation compression.

Earnings reports for Q1 have been mostly better than expected, but even for companies that also gave encouraging guidance, stocks have broadly sold off. Revenue and earnings growth estimates indicate expectations for an environment of moderate earnings growth… rev g +7-9% this year and next, with mid-single digit earnings growth[[2]](#endnote-2). This paints a positive picture, not one of sell and go away.

However, price-to-earnings ratios (P/E) have declined…not a bad thing if you’re looking to put cash to work, but potentially painful if you hold highly valued stocks. Six months ago, the P/E for the S&P500 Index was over 20x… now it is closer to 17x[[3]](#endnote-3). Some of this multiple compression is deserved. In the zero rate, risk on investment environment of 2020-2021, many stocks were bid up with little regard to fundamentals or potential profitability. Times have changed. Lower quality stocks are still getting punished, and they are dragging down higher quality companies with them, creating opportunities, in our minds.

Further, bonds have historically been used to provide stability to investment portfolios, but this year has been different. Bond performance has correlated higher to stock performance than usual, and 2021 has seen the worst bond market performance in four decades. The bond market does not wait for the Fed to take action, and lower bond prices indicates that market participants are anticipating future Fed moves. Meaningfully higher long-term rates could occur, but we believe that happens only if the Fed’s playbook changes dramatically.

As we wait to see how long it takes for the Fed’s plan to raise interest rates to curb inflationary pressures, we will continue to monitor the outlook for earnings and economic growth. We believe that a recession in some form may be unavoidable, but we also believe that stock and bond prices may be pricing in that likelihood more and more as time passes. Recessions are part of an economic cycle. We’ve experienced them before, and we will again, and again over time. Stock and bond markets have recovered from recessionary conditions before, and we expect it to happen again, but a longer term view is likely needed, unlike what the television talking heads emphasize. As investors, we remain patient as this cycle plays out, and continue to use prudence in balancing portfolio risk and diversification.

As always, thank you for letting us help you strive toward your financial goals!

Sincerely,

Gary Orf, CFA®

1. Thompson Reuters data, May 19, 2022 [↑](#endnote-ref-1)
2. Zacks Investment Research, May 13, 2022 [↑](#endnote-ref-2)
3. JPMorgan Investment Research, May 16 2022

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   The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.

   The Nasdaq Composite Index is a market-value weighted index, which measures all securities listed on the NASDAQ stock market.

   Russell 2000 Index is an equity index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks.​

   The MSCI EAFE Index is a free float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI EAFE Index consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

   The Barclays U.S. Aggregate Bond Index is a broad-based bond index comprised of government, corporate, mortgage and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.

   Please note an investor cannot invest directly in an index.

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