jhh wealth advisory
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Letter to Clients
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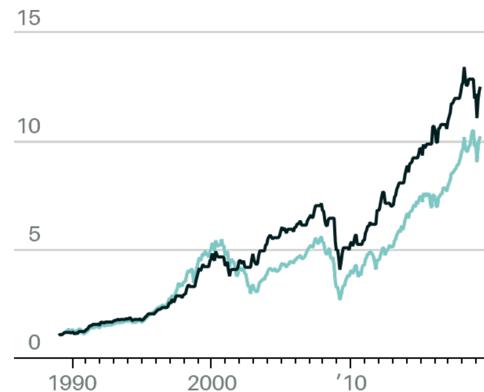
jhh wealth, llc

August Market Outlook: Sell in May and Go Away?

Among financial professionals, "Sell in May and Go Away" is a well-known adage. This adage refers to historic market underperformance from May to October. An adage is defined as a phrase expressing a general truth – and in this case, there is not an exception.



The phenomenon has been studied, and while no unanimous consensus for the summer lull exists, most believe low liquidity due to potential market participants allocating their time and money to the summer vacation season is the cause.[1]

If there is indeed correlation between peak vacation season and market volatility, one would think that the summer of 2021 reopening from COVID-19 lockdowns would be the coup de grâce against opponents of this theory. Let's start with the fact that (coincidently very close to the May start date of the adage) by April 18th half of all US adults had received their first vaccine doses, and on April 19th the vaccine had become available to all adults.[2] By May, most of the stimulus money had been sent out. Simply put, there was massive pent-up demand from newly vaccinated Americans flush with $1400 in stimulus checks. The mother of all vacation seasons was upon us.

A very active vacation season was a common prediction.[3] Fast forward to August 2021, and we can now use the power of hindsight to confirm that these predictions came to fruition. For example, bookings (flights, hotels, rentals, etc.) are matching and in some cases exceeding pre-pandemic levels.[4]

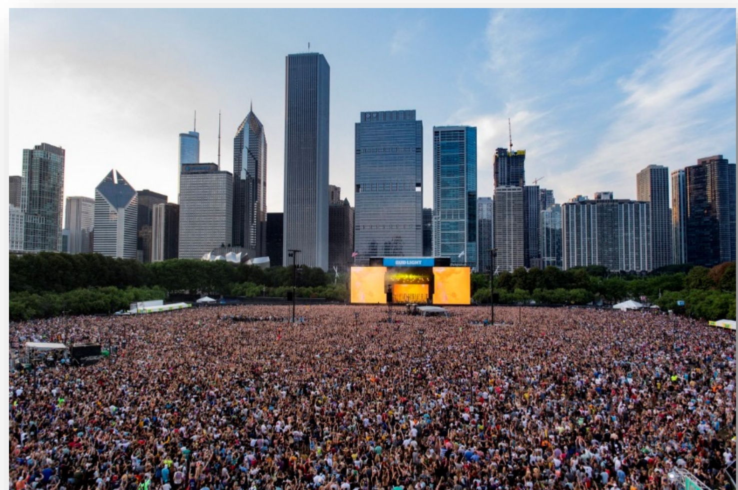


Figure 1: Lollapalooza Chicago. July29th - August 1st, 2021

With this knowledge at their disposal, proponents of the "sell in May and go away" adage would surely assume that the markets have underperformed. In actuality, the S&P 500 has risen 5% since the first trading day of May until the last trading day of July.[5]

Though the markets have been positive through the summer, it is only August 1st and the adage considers October the end of the avoidance period. Historically, August has been among the worst months of the year for the stock market.

S&P 500 Monthly Returns				
Month	Since 1950	Past 20 Years	Past 10 Years	Post-Election Year
January	1.11%	-0.05%	1.50%	0.77%
February	-0.05%	-0.58%	1.21%	-1.52%
March	0.99%	0.46%	-0.13%	0.55%
April	1.628%	2.53%	2.34%	1.55%
May	0.23%	0.38%	0.04%	1.70%
June	0.11%	-0.62%	1.02%	-0.64%
July	1.13%	1.19%	2.04%	2.16%
August	0.02%	-0.15%	-0.12%	-1.43%
September	-0.48%	-0.77%	-0.59%	-0.46%
October	0.77%	1.07%	1.65%	1.02%
November	1.71%	2.19%	2.73%	1.81%
December	1.505%	0.72%	0.19%	0.55%

Furthermore, current markets are faced with a concerning backdrop – inflation and the Delta variant being two common examples of investor anxiety. And finally, market corrections (corrections are considered a market decline of at least 10%) occur every 1.87 years, on average.[6] Considering we are 1.6 years removed from the most recent correction, a selloff is simply due.

In conclusion, is jhh recommending that investors "Sell in August and Vanish" (sorry, nothing rhymes with August)? Not quite. We have used the well-known adage as the overarching tie-in of our commentary, so we will revisit it to conclude our thoughts. Thus far the adage has been defied, highlighting the resiliency of the markets.

Historical phenomenon aren't the only negative indicators being discarded by these markets: historically high valuations, overzealous speculation in questionable investments, and the previously mentioned pandemic and rising inflation concerns are just some of the obstacles the markets continue to trample over. We believe that low yields (most investors have little options outside of equities to achieve returns), a Fed that continues to be dovish, and the ongoing pent up spending demand of consumers will continue to provide upside momentum. However, we believe that the case for a sell-off is increasing in credibility, so while jhh is not going full defensive, we are beginning to increase the defensive posturing of our portfolios as the reason for concern increases.

Tactical Asset Allocation: Views and Rationale

5 – Strong OW | 4 – Moderate OW | 3 – Neutral | 2 – Moderate UW | 1 – Strong UW

Asset Class	Views	Rationale
Equities		
US Large Cap	(3)	The current low-rate environment restricts the opportunity for outsized returns to equities. Therefore, jhh expects that the lack of options will continue to support the markets until Fed tapering commences. We believe the Fed will remain patient and that tapering remains a ways off. Concerns are warranted, however. If concerns become a reality, more risky and overvalued areas of the market will experience a harsh selloff. Financials and healthcare appear to be undervalued and positioned well for a slowing economy and rising rates.

US Mid/Small Cap	(2)	The smaller the company, the riskier the investment tends to be. Small and mid-cap companies have fared well in the low-rate, high stimulus environment. Inevitably, we believe that rates will rise, and stimulus will come to an end. Smaller companies may have hit their peaks, so an overallocation may not be prudent. A selloff may occur if the concerns outlined above become realities. We recommend an allocation to small/mid as part of the efficient frontier, but not an overweight.
Developed Equity	(4)	Many international developed countries have lagged the USA in recovery due to delayed vaccine rollouts. Developed countries appear to be well positioned to play catch up as their own re-opening booms occur. In particular, the United Kingdom has very strong vaccination numbers.
Emerging Markets	(2)	China dominates weightings in most emerging market ETFs. China's economy grew at a slower pace than predicted last quarter. This, combined with government crackdowns and the Delta spread, provides too much risk to recommend a sizeable position in emerging markets.
Fixed Income		
US Fixed Income	(1)	jhh usually segments domestic fixed income into their respective sectors and opines on each. However, we are placing a blanket underweight on most credit due to historically tight spreads[7] and recent action in yields. As recently as March of this year, the 10-year was yielding ~1.60%, a 77% increase from pandemic lows. Many analysts predicted that the 10-year would continue to rise, with rates higher than 2% a common near-term projection.[8] Bond prices fall as yields rise, so investors were faced with the predicament of a continued depreciation of capital. Fast forward to July, and the 10-year yield has fallen to around 1.20%. jhh encourages investors to cash in on the resulting appreciation in capital, as bond prices have risen due to the fall in rates. jhh believes that rates will in fact inevitably rise. This projection, combined with historically tight spreads, leaves little room for value in fixed income. Simply put, jhh recommends traditional domestic fixed-income allocations be substituted for other investments and/or strategies.

Developed Fixed Income	(1)	Investors continue to face zero-to-negative rate policies across the globe. Like domestic fixed income, investors should work with their advisors to find suitable risk-adjusted return elsewhere
Emerging Market Debt	(4)	In emerging markets, worries about the global recovery have heightened since the onset of the COVID-19 Delta variant. Individual considerations have arisen as well – for example, there is growing concern over the credit situation of Chinese property developers (China being a large piece of many emerging market allocations).[9] Despite concerns, jhh believes there is value in emerging markets due to appealing yields. Money flows seem to agree with our sentiment – in 2021, emerging market debt has seen the largest inflows since 2017.[10] jhh believes these flows are justified, even at the beginning of August. In fact, emerging market spreads have recently widened, creating an opportunity for sidelined investors to buy in. jhh encourages investors to be strategic about emerging market allocation. Individual countries have their own circumstances which may warrant avoidance. jhh recommends working with your advisor to identify specific opportunities in sovereign securities.

OW: Overweight
UW: Underweight

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Disclosure

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