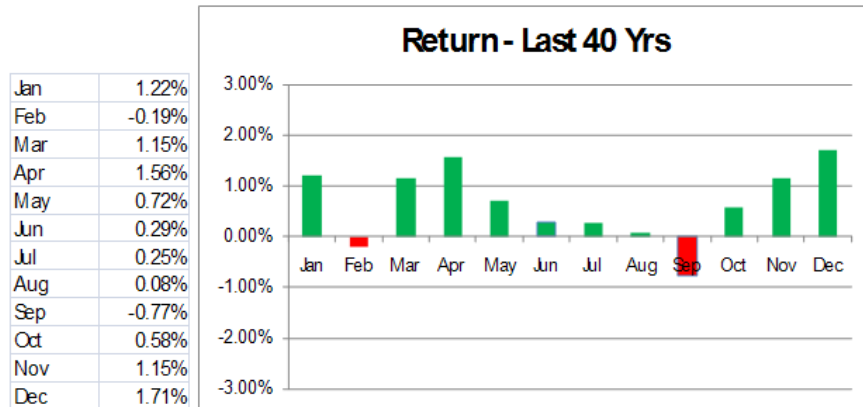


Sell in May and Go Away?

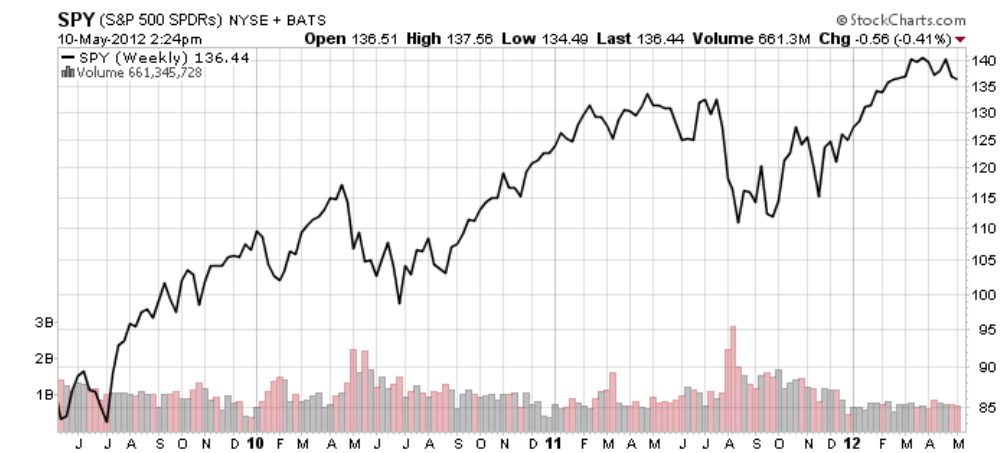
There is a very old cliché on Wall Street that advises stock investors to “sell in May and go away.” Of course, they mean for you to get back in at some point and usually the last week of October is the time to get back in, according to fans of this proverb. Does this make sense to do? Here are the results for the last 40 years by average return in each calendar month:



Source: <http://squirrelers.com/2011/01/31/2126>

Note that October has had more than its share of large selloffs but the gains in the last 7-10 days plus the gains in the non-selloff years, which are many are enough to push the average return to the positive side. Most but not all bear markets have started sometime between April and October. So, that’s the positive case for this market proverb.

This is a chart of the S&P 500 stock index over the last three years. It’s pretty good, with a very nice upward trend in prices, albeit with a fair amount of volatility.



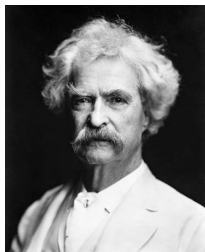
In both 2010 and 2011 the market topped out in mid to late April and proceeded to lose 20% before bottoming out in the summer and moving up again. In 2012 the market started to roll over again in late

April, within a week of the dates in 2010 and 2011. Inquiring minds what to know, “Is the market going to go through the same pattern as the last two years?” If so, should I sell now?

Part of the answer is in the chart above. In both cases the selloff bottomed in the summer (June and early August) and started up again. By the end of October were significantly higher than the bottom and had made up a good bit of the drop on their way to fresh highs.

Let’s look at the last 10 years. The year 2002 was the climactic year of a terrible bear market. The market bottomed in October so sell in May worked great. In the five bull market years of 2003-2007, in 4 of the 5 years you would have lost money by selling in May and buying back in late October and roughly broken even in the other year. In 2008 selling in May would have saved you money during the summer and early fall but if you bought back in during late October you participated in most of the drop that year. In 2009 selling in May was a terrible strategy as mid-March was the bottom of that bear market. In 2010 the strategy was a loser; in 2011 it was a winner. So in the last 10 years sell in May and go away was a losing strategy compared to buy and hold in 7 of 10 years and there was 1 breakeven year. That is not a great record, especially when you consider that 40% of the last 10 years were spent in bear markets (2002, 2007, 2008 and early 2009) which tilts the odds in favor of being out of the market. Bottom line - this is another market timing scheme that initially seems to make sense but has usually not worked in the last ten years.

Déjà vu



Some of you may know that I collect quotes. One of my favorite Mark Twain quotes is “history does not repeat itself but it rhymes.” That seems especially true when looking at economic news in 2010, 2011 and 2012.

In each of those years, the first quarter featured good economic news, problems in Europe and higher US stock prices. Each year in April the economic news on growth and employment numbers turned lower and stocks sold off sharply.

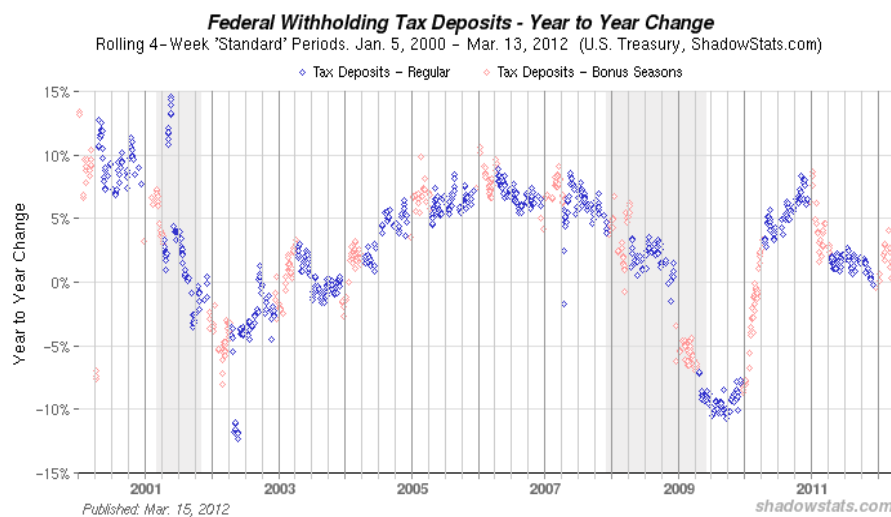
In 2012, the pattern has repeated in economic news. The stock market reaction to that has been relatively mild so far in 2012 with the S&P 500 dropping only 2.6% from its YTD high. Still, people worry that as in the movie Matrix a feeling of déjà vu may indicate a glitch in the system.



Employment

I have written at length about the unemployment reports. The seasonal adjustments made each month, including an estimate of job gains in small business seem to be too high in the winter and come back to earth in the spring. In 2012 much of that was due to a very warm winter in much of the country pulling into winter sales and construction that normally happens in spring. In 2011 part of the blame for the spring downturn was for repercussions from the Japanese tsunami, though most of that impact was felt in June to November.

One way I haven't shown the employment picture is the level of federal income tax withholding deposits. That gives a good indication of how much money people are making. The chart below shows the last 12 years.



As you can see, we are past the worst (2009) but the recovery has been falling apart the last 15 months. We are now back to the deposits of 10 years ago even though the population has grown since then. Federal spending has grown a lot in the same time. If some of the current level of tax deposits is due to

population growth then the average taxpayer's income has declined over the last 10 years.

While that concerns me, we all know the Great Recession is still going on. What concerns me more is the recent downward trend. That needs to reverse.

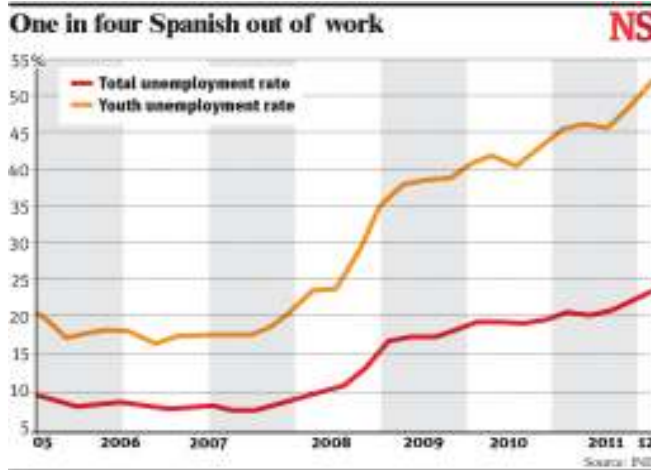
Europe



There were two big news items from Europe during the last month, both having to do with elections. The first is that anti-austerity candidates in Greece garnered a sizeable share of the vote, enough to keep the parties in favor of compliance with bailout austerity requirements from being able to cobble together a majority coalition and form a government. So far no party has been able to put together a government and if that holds, another election will occur in June.

This raises the odds of Greece failing to comply with its lenders' requirements for more bailout money and thus raises the odds that Greece will have to exit the Eurozone and dump the euro in favor of the Greek drachma. I think that would be best for Greece but the fear is that Portugal and Spain would be next and that would wipe out the Eurozone's southern flank except for Italy.

Spain has very serious problems, mainly related to very high unemployment and a poor banking system.



The overall rate is 24%+ and youth unemployment (ages 16-25) is over 50%. Spanish banks have not had to report their losses related to a collapsed housing market and are in much worse shape than their public records indicate.

The problems in Greece aside from an enormous debt load borrowed at low Eurozone rates and now being refinanced at high rates, are a huge annual deficit, an economy that under austerity has shrunk by 20% and is

Source: <http://www.newstatesman.com/economics/employment/2012/04/chart-day-one-four-spanish-are-out-work>

forecast to shrink another 8% in 2012, rampant corruption, red tape on a scale Americans cannot imagine, tax cheating being seen as a time-honored tradition and wages that are too high to be competitive. The red tape is the result of a very over-sized government. I saw a segment on CNBC a few months ago in which a person was interviewed who was trying to open a small coffee-shop. After 2 ½ years she was still waiting to receive all her various regulatory approvals. How do you start a business and hire people in that environment?



Another problem across Europe is that it is very hard to fire people because unions are so strong and laws are in place strongly protecting employees from dismissal. While those sound like positives, it keeps businesses from wanting to hire people in down times because the costs of salaries and benefits are so high and there is little to no flexibility in managing the labor force. Without new hiring there is no recovery.

GDP

Economic output (GDP) for the U.S. in the 1Q was reported as 2.2%, which was lower than expected. However, real demand was better than expected so really the report was OK. Inflation came in around 2%.

Growth of just over 2% is OK in our current relatively slow growth world as people recover from the financial excesses of the 80s, 90s and early 2000s. But as Europe continues deeper into recession our growth may be hindered to some extent, as will China's. Europe is the largest Chinese export market.

Strategy



For most accounts, I have initiated buys recently in UNG, the exchange traded fund for natural gas. I think gas has hit a major long term bottom. Our fixed income positions remain and are doing well. We are slightly underweight in stocks and tilted fairly conservative but that may change soon, depending on how this correction goes.

Dave Hoshour

Cornerstone Investment Services

A Fee-Only Investment Manager

3003 Thorndale Rd.

Indian Trail, NC 28079

704-698-1040

888-320-4495 fax

800-566-2721 toll-free

DaveH@CornerstoneInvestment.com

www.CornerstoneInvestment.com