<u>Monthly Outlook: May, 2016: "Sell In May and Go Away?"</u>

With the advent of the month of May, the old saw ***"Sell in May and Go Away"*** appears to be receiving much press lately – especially as equity markets have risen significantly since their volatility in mid-February. Indeed, as we look out over the next couple quarters, it is commonly perceived wisdom that if anything, volatility is likely to increase, not decrease.

A number of "events" like the Brexit vote in the UK (June 23rd), the Spanish elections (June 26th), the US Presidential Election Conventions (Mid to late July) and the actual campaign season, suggest that markets could reset to a different reality. In addition, we do also have meetings of the Federal Open Market Committee of the Federal Reserve (***"every meeting is a live meeting"***) on June 15th, July 27th, September 21st, November 2nd and December 14th – which could all lead to some additional "fireworks".

Economic data released in the US have been ***relatively mixed***: The US economy added a worse than expected 160,000 jobs during the month of April. Professional and business services (+65k) and education and health services (+54k) accounted for the bulk of the net new jobs, while government (-11k) and mining and logging (-8k) posted the largest job losses. Average hourly earnings were up 8 cents for the month, but posted an annual gain of 2.5% from the same month a year ago.

The ***unemployment rate*** remained unchanged at 5.0% despite a small fall in the labor force participation rate (which declined from 63.0% in March to 62.8% in April). The ***U-6 measure***, a more robust measure of unemployment, in our opinion, also declined one-tenth to 9.7% as the median period that an individual is unemployed stayed stubbornly stuck at 11.4 weeks during the month.

Data from the Job Openings and Labor Turnover (***JOLTS***) report for the month of March – one that is not as scrutinized as the monthly nonfarm payroll report – did contain ***good tidings***: The number of job openings remained roughly unchanged at 5.8 million jobs, and the ***quit rate*** – those leaving their jobs – either voluntarily or involuntarily was at 2.3% in the private sector, with the "separation rate" also staying roughly unchanged at 1.2%.

The difference between the quit and the separation rate indicates those leaving their jobs voluntarily (presumably in search of better opportunities elsewhere). The theory is that employees tend not to quit voluntarily unless they actually perceive the ***job market to be improving*** and their future prospects (yes, our inner Yogi Berra is showing) to be positive. While this tends to be anecdotal to some extent, it has become fashionable to watch the quit rate as apparently this is one of the indicators that Janet Yellen pays attention to.

In other data, the Institute of Supply Management's Purchasing Managers' Index declined a full percent in April to 50.8 (from 51.8 in March) while the Non-Manufacturing Index (a measure of health of the service industry), rose 1.2 points to 55.7 in April (from 54.5 in March). Nonfarm Productivity ***declined -1.0%*** during the 1Q further underlining worries about declining productivity placing a lid on the potential growth rate for the US economy.

A new series put out by the Atlanta Federal Reserve Bank called ***"GDP Now"*** has received much play recently. Supposedly, this series closely tracks GDP for the current quarter based on contemporaneous pieces of economic data as they are being released. The GDP Now reading for 2Q2016 is at 2.2% (seasonally adjusted annual rate); compare this to the abysmal 0.5% reading for GDP growth for 1Q2016 (as released by the Bureau of Economic Analysis of the Department of Commerce) and one wonders what is going on with the economy.

GDP growth has posted disappointing numbers for the first quarter for three consecutive years in a row – for 2014 (-0.9%), 2015 (0.6%) and now 2016 (0.5%). While ***faulty seasonals*** might be partially to blame (these figures are indeed seasonally adjusted), it goes without saying that there seems to be something strange going on at the beginning of every year. In 2014, it was the polar vortex that conspired to keep people in their homes, but bad weather did not appear to be a problem in either 2015 or 2016.

The past month has also seen some progress in the ***media spectacle*** also called the US Presidential campaign: Donald Trump now appears to be the presumptive nominee on the Republican side while Hilary Clinton seems to be the choice on the Democratic side. We will refrain from passing judgement here on the virtues of either candidate. Suffice it to say that many political pundits seem to be shaking their heads as this is ***"unlike any political season we have ever seen".***

There seems to be a sizable section of the electorate **-** on both sides of the aisle – where voters feel ***disenfranchised*** which leads to the invariable protest vote – especially against candidates that stand for the status quo. This seems to have intensified as the median income of many families appear to have stagnated over the past two decades or so. While ***democracy is by definition messy***, political discourse in this country appears to have reached ***extremes in polarization*** that we have not seen in generations thus leading to the political morass we find ourselves in. Nasty political attack advertisements and the US Presidential debates – coming to a television near you this summer!

Since the end of World War II, the S&P500 appears to garner much of its return during the months of November through April (+6.8%) and not so much during the rest of the year – May through October (+1.4%). Indeed, many of the ***"bad" months*** seem to occur when credit demands increase during the fall and early winter and October seems to be a particularly terrible month as well. So given these statistics why not "sell in May and go away?".

We do see a number of issues that could increase volatility in financial markets over the next couple of quarters including the ***Brexit*** vote (June 23rd), the ***Spanish Elections*** (June 26th) and the entire US Presidential Campaign. However, we are not big believers in such seasonal anomalies like "sell in May and go away" and much prefer to take our cue from underlying fundamentals like economic growth, corporate earnings, and valuations.

Speaking of ***corporate earnings***, with 455 companies in the S&P500 having reported earnings (=91%) so far, the share-weighted earnings change has been a ***decline of -7.6%*** for 1Q2016 (relative to 1Q2015). Taking out the impact of energy companies (=74 companies) leaves us with a still negative ***-1.6%*** for the period. The run rate for the entire index at a $26.70 for the quarter, implies an annualized gain of $106.80 – well below the $120 figure that the consensus had built in for the year as a whole.

Farther afield, news from Saudi Arabia brings the replacement of its long-serving energy minister Ali Al-Naimi by Khalid al-Falih. Al-Naimi was one of the real ***"characters"*** in the energy business. Khalid al-Falih is known to be a technocrat (a graduate of Texas A&M – an Aggie to boot!) and is personally close to Muhammed bin Salman, the 30-year-old deputy crown prince of the Kingdom. We do not believe that this will necessarily result in a change in the Kingdom's production or oil policy, but change is afoot – so stay tuned.

Despite all of this, equity markets find themselves within mere percentage points of their high from almost a year ago. Given the environment of slow growth and increased volatility, we do believe it is ***prudent to be cautious at this juncture*** rather than throw caution to the winds (pun intended!). Therefore, we will continue to monitor and reassess positions in your portfolios daily (as we always do), and likely carry ***higher than usual*** cash balances despite it being a drag on near-term investment performance.

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