STOCK TRADER'S ALMANAC

BEST MONTHS SWITCHING STRATEGY

WILEY

Sell in May... and Then What?

The old stock market adage of "Sell in May and Go Away" won't cut it these days. You need a consistent, low-risk strategy that will help you take advantage of seasonal trends and continue to generate wealth in retirement portfolios during the sluggish summer months.

Jeffrey A. Hirsch's "Best Six Months" Switching Strategy

In conjunction with *Wiley's Stock Trader's Almanac*, Jeffrey A. Hirsch has developed a strategy called "Best Six Months" switching stragtegy which allows you to take advantage of seasonal, year-in and year-out market trends to create lasting wealth in your retirement portfolios without sitting on the sidelines during the slow summer months and most importantly, taking advantage of the best six months November-April!

"Best Six Months" switching is essentially the flip-side of the old British stock market saying of:

"Sell in May and Go Away." This phrase is not a creation or strategy of "Sell in May and go away; come back on St. Legers Day." In turn of the century London, the coming of the month of May typically meant business and financial activity slowed down as folks left the city for the country in order to beat the heat. In September, right around the time of the St. Legers Stakes race (the final leg of the English Triple Crown), business and financial activity generally picked up again. The U.S. version of this would be the Memorial Day-Labor Day summer doldrums.

> *"It's always worth holding on to high-performing stocks, summer or not."*

Though times have changed and (unfortunately) few people can go on vacation for an entire summer, there is clearly a long-standing correlation between sluggish equities performance in summer and more robust performance starting in the autumn months; however, the selling everything and going away is clearly imprudent. Selling out of equities during major market breakdowns like the spring of 2008 is quite understandable, but it is never advisable go away entirely. Instead, investors must stay invested in the market even in stock market downturns, whether in cash, bonds, select sectors, holding downside protection, shorting, or any number of other ways. At a bare minimum, investors and/or financial advisors must pay attention for the time to get back into equities or reallocate, and it's always worth holding on to high-performing stocks, summer or not.

The idea of "Sell in May" was never meant to be a cure-all, but it has brought attention to Jeff's Best Six Months/Worst Six Months Switching Strategy, which was first introduced in the 1987 *Almanac*. This technique of investing in the Dow Jones Industrial Average between November 1st and April 30th each year and then switching into fixed income for the other six months has produced reliable returns with reduced risk since 1950.

Sam Stovall, Managing Director U.S. Equity Strategy S&P Capital IQ, has done an excellent recent piece on the worst six months for the S&P 500 with overlay

"Invest in the Dow Jones Industrial Average between November 1st and April 30th each year and then switch into fixed income for the other six months"

on the midterm year. Stovall's research confirms Jeff's findings that not only has the market performed poorest in May-October, but it's even worse in the midterm year. Stovall also shows how bonds outperform stocks in the worst six months and even more so in the midterm year.

In fact, it's difficult to find a similar trading strategy that even comes close over the past six decades. And to top it off, the strategy has only been improving since Jeff first published it in 1986.

Jeff's Best Months Switching Strategy will not make you an instant millionaire as other strategies claim they can do. What it will do is steadily build wealth over time with half the risk (or less) of a "buy and hold" approach.

Applying Jeff's Seasonal Switching Strategy:

A conservative way to execute this switching strategy, the "In-or-Out Approach," as Jeff likes to refer to it, entails simply switching capital between stocks and cash or bonds. During the "Best Months", an investor or trader is fully invested in stocks. Index tracking ETFs and mutual funds are an easy and inexpensive way to gain stock exposure. During the "Worst Months," capital would be taken out of stocks and could be left in cash or used to purchase a bond ETF or bond mutual fund.

This approach works very well for retirement accounts where the goal is to build wealth over time. It comes with the added advantage of potentially less risk of a "buy and hold." Of further benefit, you may find summertime vacations and activities more enjoyable because you will not be concerned with stock market gyrations while your nest egg is parked in the relative safety of cash or bonds.

The approach used in the *Almanac Investor* Stock and ETF Portfolios involves making adjustments to your portfolio in a more calculated manner. During the "Best Months," additional risk can be taken as solid market gains are most likely, but during the "Worst Months" risk needs to be reduced but not necessarily entirely eliminated. There have been several strong "Worst Months" periods such as 2003 and 2009. Taking this approach is similar to the in-or-out approach; however, instead of exiting all long stock positions a defensive posture is taken.

Weak or underperforming positions can be closed out, stop-losses can be tightened, new buying can be limited, and a hedging plan can be implemented. Purchasing out-of-the-money index puts, adding bond market exposure, and/or taking a position in a bear market fund would mitigate portfolio losses in the event a summer pullback manifests into something more severe such as a full blown bear market.

Examples of Tradable Funds:

A sampling of tradable funds for the Best and Worst Months appears in the table below. These are just a starting point and only skim the surface of possible trading vehicles currently available to take advantage of these strategies. Your specific situation and risk tolerance will dictate a suitable choice. If you are trading in a tax-advantaged account such as a company sponsored 401(k) or Individual Retirement Account (IRA) your investment options may be limited to what has been selected by your employer or IRA administrator. But if you are a self-directed trader with a brokerage account, then you likely have unlimited choices (perhaps too many).

Tradable Best and Worst Months Switching Strategy Funds

Best Months Exchange Traded Funds (ETF) Symbol	Name
DIA	SPDR Dow Jones Industrial Average
SPY	SPDR S&P 500
QQQ	PowerShares QQQ
IWM	iShares Russell 2000

Mutual Funds Symbol	Name
VWNDX	Vanguard Windsor Fund
FMAGX	Fidelity Magellan Fund
AMCPX	American Funds AMCAP Fund
FKCGX	Franklin Flex Cap Growth Fund
SECEX	Guggenheim Large Cap Core Fund

Worst Months Exchange Traded Funds (ETF) Symbol	Name
SHY	iShares Barclays 1-3 Year Treasury Bond
IEI	iShares Barclays 3-7 Year Treasury Bond
IEF	iShares Barclays 7-10 Year Treasury Bond
TLT	iShares Barclays 20+ Year Treasury Bond

Mutual Funds Symbol	Name
VFSTX	Vanguard Short-Term Investment-Grade Bond Fund
FBNDX	Fidelity Investment Grade Bond Fund
ABNDX	American Funds Bond Fund of America
FKUSX	Franklin U.S. Government Securities Fund
SIUSX	Guggenheim U.S. Intermediate Bond Fund

Generally speaking, during the Best Months it is ideal to be invested in equities that offer similar exposure to the companies that constitute Dow, S&P 500, and NASDAQ, and Russell 2000 indices. These would typically be large-cap growth and value stocks as well as technology concerns. Reviewing the holdings of a particular ETF or mutual fund and comparing them to the index members is an excellent way to correlate.

During the Worst Months, switch into Treasury bonds, money market funds, or a bear/short fund. Grizzly Short (GRZZX) and AdvisorShares Ranger Equity Bear (HDGE) are two possible choices. Money market funds will be the safest but are likely to offer the smallest return, while bear/short funds offer potentially greater returns but more risk. If the market moves sideways or higher during the Worst Months, a bear/short fund is likely to lose money. Treasuries can offer a combination of decent returns with limited risk.

Additional Worst Month possibilities include precious metals and the companies that mine them. SPDR Gold Shares (GLD), Market Vectors Gold Miners (GDX), and ETF Securities Physical Swiss Gold (SGOL) are a few well recognized names available from the ETF universe.

Example of a Different "Sell in May" Seasonal Trade

Take advantage of seasonal May-October weakness using an option strategy, developed by our John Person, on a leveraged inverse ETF. These are the hybrid products of the 21st century. The Direxion Daily Small Cap Bear 3X (TZA) correlates to three times the daily move of the small cap index but moves opposite of the underlying market. TZA tracks the Russell 2000 index of small cap stocks, which means if the Russell 2000 declines, then TZA would move up in value.

TZA often provides a solid risk reward opportunity to apply risk capital for a seasonal short trade for the overall stock market. If the Advanced-Decline line on the Russell 2000 flashes a significant bearish divergence pattern and the small cap sector begins to significantly underperform the overall market as indicated by a breakdown in the relative strength chart as we enter the seasonally weak time period for stocks, you can consider an advanced options trading strategy such as a vertical bull call spread on TZA.

Best Six Months Strategy as an Entry Point for Greater Interaction With Clients

"One of the main reasons clients leave their financial advisors: lack of attention and personal contact. "

One of the main reasons clients leave their financial advisors: lack of attention and personal contact. By giving the *Stock Trader's Almanac* to your clients, you're giving them the gift of information, access and unique market insights they cannot find elsewhere. Coupled with the other benefits you're already offering – great customer service, access to knowledgeable staff – keeping clients informed on trends in the market makes a winning combination. As an extension of the personal service you offer, the *Stock Trader's Almanac* makes a great ongoing and tangible asset to encourage regular communication, improve your customer's portfolio, and grow your business.