



Market Bulletin

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Commentary – How to position portfolios for a short-term downturn

“Sell in May” likely to be a potent phenomenon this year

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The “Sell in May and go away” phenomenon is well-documented, but as with most seasonal trends, does not always work out. Take last year, for instance. While equities hit a downdraft from May 22 onward on concern about the Federal Reserve’s “tapering” of stimulus, the correction was brief, lasting for only a month before stocks resumed their uptrend.

Three years ago, our analysis discovered that the “Sell in May” phenomenon was even more apparent in the Canadian market than it was in the U.S. (using the TSX Composite and S&P 500 indexes as market proxies). Over the 50-year period 1961 to 2011, the average return for the TSX from May to October was 0.06%, compared with 7.60% for the November to April period, for a performance differential of 7.54%. In comparison, the performance differential for the S&P 500 over these six-month periods was 5.67%.

What about the last couple of years? The Table below shows the relative performance differential for the TSX and S&P 500 since May 2011. As can be seen, despite the unseasonably strong performance of equities in the May to October 2013 period, the November to April period has been better for equities in the U.S. and Canada.

Period	TSX	S&P 500
May 2011 - Oct.2011	-12.10%	-8.09%
Nov. 2011 - April 2012	0.33%	11.54%
May 2012 - Oct.2012	1.06%	1.02%
Nov. 2012 - April 2013	0.27%	13.13%
May 2013 - Oct.2013	7.26%	9.95%
Nov. 2013 - Mar. 2014	7.29%	6.59%
Average (May - Oct.)	-1.26%	0.96%
Average (Nov. - Apr.)*	2.63%	10.42%
* until March 31 for 2014		

Given the rising risk of a downturn in the short term, we recommend the following strategies for diversified portfolios –

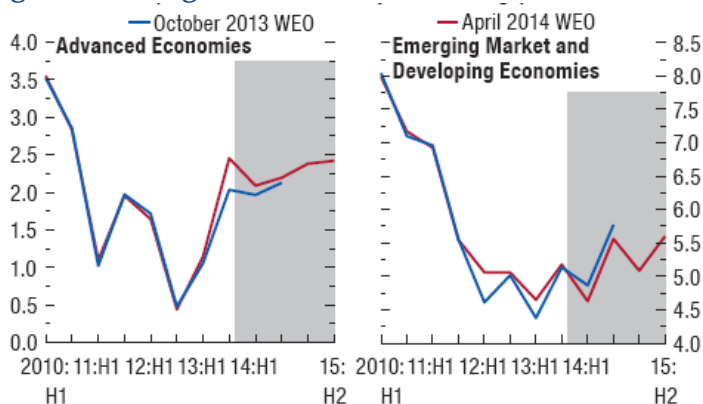
- **Use options to buy some insurance:** The VIX has been rising this week, but is still at lower levels than the average of recent years. Using September at-the-money puts on the S&P 500 and TSX-60 ETFs (SPY and XIU respectively), the cost of hedging U.S. and Canadian equity exposure works out to 10.4% and 8.8% respectively. That does not seem unduly expensive for buying some peace of mind.
- **Stay defensive:** It might be best to focus on the defensive side of the equity spectrum for now, rather than the cyclical side. Defensive groups like Utilities and Telecoms are flat on the TSX over the past year, although Utilities are up 9.1% this year for the second-best YTD performance on the index. On the S&P 500, Telecoms and Utilities are the worst performers over the past year, but the Utilities group has moved into the top position YTD with a 9.6% gain. Investors are gravitating towards defensive equities with above-average dividend yields and stable cash flows, and this sector rotation can be expected to continue in the near term.
- **Avoid momentum plays** – This has been another horrendous week for momentum stocks in the U.S., as the continuing selloff in technology and biotech stocks took the Nasdaq-100 down 4.1% for the week. We strongly recommend avoiding these sliding momentum plays at the present time.

Chart of the Day

Faster global growth should support equities and mitigate the risk of a steep correction

The IMF this week lowered its forecast for global economic growth this year and next by 0.1 percentage point (from its January estimate), to 3.6% and 3.9% for 2014 and 2015 respectively, an appreciably faster growth rate from the past two years (3.2% in 2012 and 3.0% in 2013). The chart below shows the IMF's growth forecast for the advanced economies and emerging market / developing economies. In our opinion, faster global growth should be equity-supportive, and could help mitigate the risk of a steep market correction.

Figure 1: GDP growth (annualized semi-annual % change)



Source: IMF World Economic Outlook April 2014

Market Snapshot

At close on Friday, April 11, 2014

S&P TSX	14257.69	-50.31	Commodities			Yields (%)	Can.	US
TSX Venture	997.77	+4.08	Canadian \$ (US cents)	91.09	-0.36	90 Day T-Bill	0.91	0.04
DJIA	16026.75	-143.47	Gold (Spot)-US\$	1318.42	-0.48	2-Year Bond	1.04	0.35
S&P 500	1815.69	-17.39	Oil (WTI-May)	103.74	+0.34	10-Yr. Bond	2.39	2.62
NASDAQ	3999.73	-54.37	CRB Index	309.39	-0.80	30-Yr. Bond	2.94	3.48

Thought for the Day

“It is our choices... that show what we truly are, far more than our abilities.” – J.K. Rowling

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