Partner Talk®

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Sell in May and Go Away?

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Summer is my favorite time of year. I think this is due to the fact that the season brings with it warmer weather and a number of outdoor activities like BBQ's, parties, trips to the beach, playing tennis, riding bikes, holidays, etc. Every year, as summer approaches, I tend to recall the old adage that is the title of this month's Partner Talk letter, "Sell in May and Go Away".

I first heard this saying twenty-four years ago, when I had recently started in the financial services industry and worked on the government bond trading desk of a Wall Street investment banking firm. While more of a folk tale, it came from the belief by some equity traders that if you sold all your equities in May, went to the beach for the summer and didn't buy back equities until September or October, you would do better than if you had held all of your equities during this time period.

While I could spend the rest of this letter discussing whether or not the data backs-up this adage, that isn't really the point as this type of strategy is really just market timing – something that clients of PMA know we don't believe works over the long-run. That being said, however, there is something kind of romantic about the idea of being able to "go away" for the summer, enjoy yourself and not be worried about the ups and downs of the market.

Certainly, professional investors like PMA who have fiduciary responsibility for our clients' assets don't have the luxury of going away for the summer with no concern for what is happening in the market. But, for our clients, I suggest that one of the benefits of having an investment advisor that uses a prudent, well-designed and time-tested investment philosophy is that you can and should be able to go away, enjoy the summer and not worry about what happens in the market.

While this does not mean that the market couldn't potentially drop significantly at some point this summer - it certainly could - it does mean that, if your investments are allocated in a well-diversified portfolio with an appropriate level of risk then our goal is that you should be able to withstand any short-term market drops that will inevitably happen.

If, before going away for the summer, you would like an update about what we are doing with our portfolios and thinking about the economy/markets, then keep reading:

<u>Economy</u>
The economy is doing well and the odds of a recession in the next 6-9 months appear to be low. The just released May employment report showed that the unemployment rate dropped to a seasonally adjusted 3.8%, matching April of 2000 as the lowest reading since 1969, and average hourly earnings rose 2.7% from a year earlier. Consumer confidence remains high and corporate earnings are strong. Earnings are going up because of the tax bill enacted this year and the dramatic increase of company stock buybacks. This means that the Federal Reserve is likely to go ahead with possibly two to three more rate increases, which would result in the Fed Funds Rate at the end of the year ranging between 2.25% to 2.50%.

While we cannot be certain about the potential effects of new U.S. tariffs on steel and aluminum and the likelihood of a trade war that could result, we are hopeful that some kind of deal that allows all parties to be able to claim a victory will ultimately be worked out.

<u>Asset Allocation</u>
Given the above reading on the economy, we are maintaining our overall allocation between equities and fixed income at the upper end of the allowable range in all of our portfolios. There has been, however, a fair amount of uncertainty in the fixed income market recently, and interest rates have been trending higher due to the strengthening economy. As a result, we have been in the process of making our fixed income portfolios less sensitive to interest rate increases.

To do this, we have been reducing the duration (the higher the duration of a bond portfolio, the more its price will drop as interest rates rise) of our bond portfolios by taking some money out of intermediate investment grade bonds and putting it into both a high yield bond fund and short-term investment grade bond funds. This means that, for the fixed income portfolio of our clients' portfolios, we will be reducing the allocation of intermediate bonds from 40% to 30%, putting 5% in high yield and 5% in short-term bonds. This will make our fixed income portfolios less sensitive to increasing interest rates while also taking advantage of the higher interest coupons available from the high yield bond fund.

Additionally, after watching for months, we have observed that the correlation between international equities and U.S. equities has decreased considerably, thereby enhancing the diversification benefits of owning international equities. For this reason, we will be gradually increasing our allocation to international equities from 20%-25% of our clients' equity portfolios. This should result in less volatility over the entire equity portfolio which, in turn, will help our clients achieve a higher risk-adjusted return.

Rest assured that we will continue to monitor the economy, the markets and our clients' portfolios just as we always have for the past 35 years. Therefore, assuming your risk tolerance matches the level of risk in your portfolios, you really can go away and enjoy your summer without having to "sell in May." If you are uncertain or have any questions about your risk tolerance, please do not hesitate to contact us to discuss.