PRIVATE CLIENT SOLUTIONS

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Insights & Strategies

Sell in May … Not Today

Please read domestic and foreign disclosure/risk information beginning on page 7. ; Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2. 2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

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Sell in May … Not Today

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We rely daily on simple rules to navigate the world around us. Heuristics are mental shortcuts commonly used to simplify problems and avoid cognitive overload. While spending the time to thoughtfully consider all the possible scenarios may produce a more optimal outcome, a mental shortcut often offers a satisfactory solution. If it's cloudy outside, we bring an umbrella. However, if we had opened the weather app, we would have learned it would be a beautifully sunny day during the hours we planned to be outside.

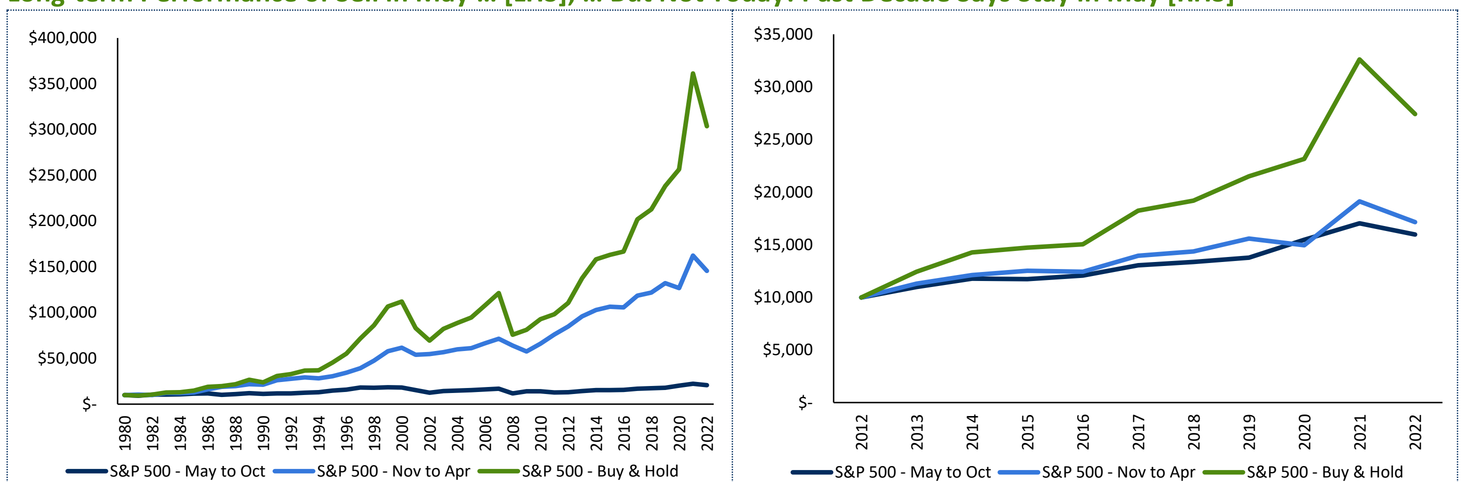
In finance, mental shortcuts are rules of thumb that provide simple solutions to complex problems. "Sell in May and go away" is one such classic example. This theory postulates that investors should exit the market between May and October while staying fully invested from November to April.

The November to April period indeed produces superior returns. Since 1981, 69 per cent of the time, November to April returns have exceeded those of May to October. The average return was 7.0 per cent versus 2.2 per cent, respectively. But for the sell-in-May theory to outperform a buy-and-hold strategy, one must invest the cash proceeds for six months at an annualized yield of approximately 4.5 per cent. In the good old days, when cash offered a competitive return, this strategy may have made sense (more on this later).

As with any rule of thumb, this is worth revisiting occasionally. Over the past decade, the sell-in-May rule has been even more ineffective. The average May to October return has increased to 4.9 per cent (10.1 per cent annualized), thus creating an increased drag on performance for those following the shortcut and exiting the market.

A possible explanation for the improved May to October return profile over the past decade may have been the lack of alternatives to stocks (remember TINA: There Is No Alternative). While bonds and cash offered capital protection over the past decade, they provided little in return. Today, that has changed. It will be interesting to revisit this rule of thumb to see if the May to October return reverts toward its historical average.

Long-term Performance of Sell in May … [LHS]; … But Not Today! Past Decade Says Stay in May [RHS]



Source: FactSet; Raymond James Ltd.; Data as of October 31, 2022. For illustration only. Chart (left): start investing on December 31, 1980 with an initial investment of $10,000. Chart (right): start investing on December 31, 2012 with an initial investment of $10,000.

Time for a Pause

Perhaps the paradigm shift away from "There Is No Alternative" (TINA) will change the future dynamic of sell in May. At least for now, there is good reason to stick around for the next several months.

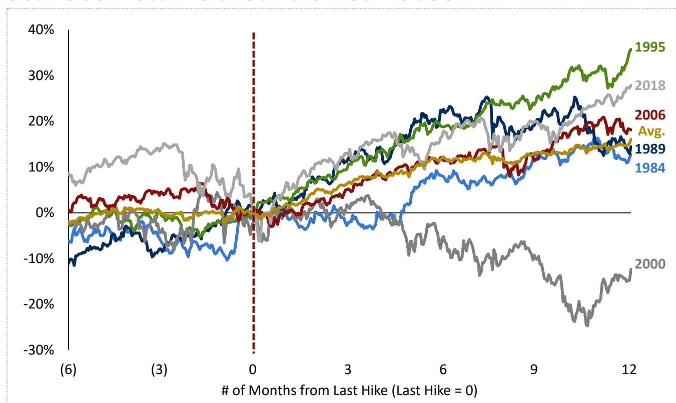
May could very well be the Federal Reserve's (Fed) last rate hike. As we discussed last month, tighter financial conditions are doing much of the Fed's heavy lifting. U.S. Treasury Secretary (and former Fed chair) Janet Yellen reiterated this point, *"Banks are likely to become somewhat more cautious in this environment…we already saw some tightening of lending standards in the banking system prior to that episode, and there may be some more to come."* More restrictive lending conditions *"could be a substitute for further interest rate hikes that the Fed needs to make".*

The point is that we are nearing the end of the hiking cycle, and once the Fed is done, markets tend to produce good returns.

The chart below illustrates S&P 500 returns leading up to, and 12 months after, a Fed pause. Over the last six cycles, the average market return 12 months after the Fed stopped hiking interest rates was 16.1 per cent.

The only exception was in 2000 when the market continued to correct from a period of "irrational exuberance" that drove the dot-com stocks to superficial high valuations.

S&P 500 Returns around a Fed Pause



Source: FactSet; Raymond James Ltd.; Data as of March 31, 2023.

That Ain't No Bull

Investor sentiment, while improved since last year, remains pessimistic, and investor positioning has become defensive. According to the BofA Global Investment Manager Survey, investors overweight bonds and cash at the expense of equities.

Simply put, plenty of new investors can enter the market and support further gains. We just need a reason to support this rotation.

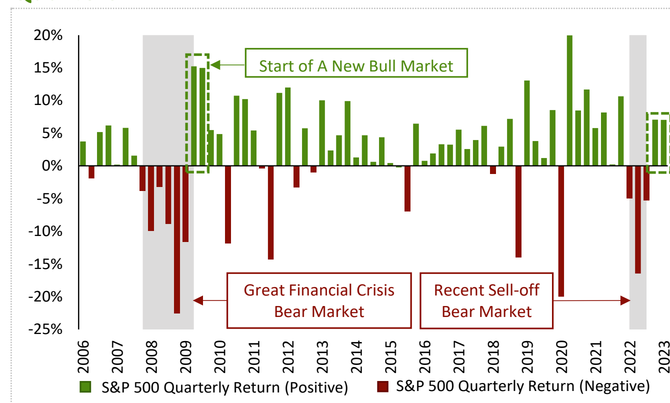
This catalyst could be any of the following: a Fed pause, a better outlook for corporate earnings, easing inflationary pressures and/or economic resiliency that delays the onset of a recession.

Or perhaps it's FOMO (the Fear Of Missing Out). The S&P 500 could very well have entered a new bull market.

As illustrated below, during the last two bear markets (2008/2009 and 2020), the S&P 500 never recorded a positive quarter, let alone two consecutive positive quarters. Only after the market exited the bear territory did we see positive quarterly returns, and similar to 2008/2009, the last quarter marked back-to-back positive gains.

We will only know in hindsight if we've entered a new bull market, but based on some indicators in recent history, the worst may very well be behind us.

Signs of Bull Market: Two Consecutive Positive Quarters



Source: FactSet; Raymond James Ltd., as of March 31, 2023.

Bottom Line

The sell-in-May rule of thumb has become less useful over the past decade, but the mental shortcut will be interesting to revisit in the coming years, as there is now an alternative to stocks. Regardless, a buy-and-hold strategy far exceeds any attempt to time the market.

As for additional reasons to stay in May, the market is predicting a Fed pause in the coming months. Historically, markets have produced solid returns for stocks 12 months after a pause. Given investor sentiment, any positive catalysts may provide additional buying demand for stocks and confirm the nascent bull market.

Strategy Committee

Ideas for Higher Market Volatility

Market volatility is an unavoidable aspect of long-term investing. During periods of economic uncertainty, when market ups and downs are more pronounced, picking stocks that have historically exhibited low beta and low volatility can serve as a stabilizing force in an investor's portfolio.

Comparison with Previous Recessions

During the 2000 dot-com bubble burst, technology stocks with high betas experienced significant price declines. In contrast, low-beta stocks in defensive sectors demonstrated resilience, offering retail investors a cushion against market declines. For instance, while the S&P/TSX Composite Index fell by approximately 30 per cent from its peak, low-beta stocks in the utilities and consumer staples sectors outperformed the broader market, providing investors with much-needed stability.

Similarly, during the 2008 financial crisis, low-beta stocks in the S&P 100 Index offered retail investors a safe haven amid market turmoil. Those stocks, primarily from the healthcare and consumer staples sectors, held their ground while the overall market experienced dramatic declines.

Methodology and Screening Process

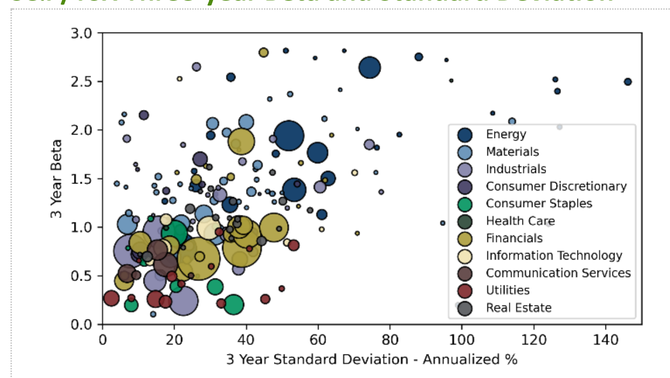
Firstly, beta is a measure of the stock's price movement relative to its broader market. When the beta for a stock is greater than one, the stock is considered more volatile than the overall market. A stock that has a beta less than one is considered less volatile. For our screening, we also looked at the standard deviation of each stock, which is a measure of how much a stock price varies from its average value. The higher the standard deviation, the greater the price has varied from its historical average value. This means the stock is more volatile when compared to its historical average.

Our screening process was conducted on the S&P/TSX Composite and the S&P 100. We then calculated the three-year beta and annualized standard deviation for the constituents in each index as well as selected securities with the lowest values. Additionally, each data point in the following graphs represents companies, whereby the colour denotes their sector and the size represents the market capitalization.

Quantitative Findings

In the S&P/TSX Index, sectors that exhibited the lowest beta and standard deviation were utilities, communication services and consumer staples. This is characteristic of their defensive nature and why they are typically favoured by investors during periods of higher market volatility. The top five securities in the index that had the lowest beta and standard deviation were **Hydro One (H-CA)**, **Metro (MRU-CA)**, **Intact Financial (IFC-CA)**, **TMX Group (X-CA)** and **Capital Power (CPX-CA)**.

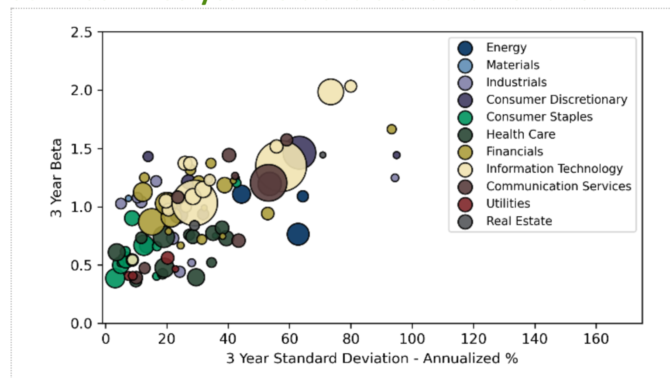
S&P/TSX Three-year Beta and Standard Deviation



Source: FactSet. Raymond James Ltd. Data as of March 31, 2023.

In the S&P 100 Index, sectors that exhibited the lowest beta and standard deviation were utilities, consumer staples and healthcare. The top five securities in the index that had the lowest beta and standard deviation were **Procter & Gamble (PG-US)**, **Bristol-Myers Squibb (BMY-US)**, **Southern Company (SO-US)**, **Verizon Communications (VZ-US)** and **Coca-Cola (KO-US)**.

S&P 100 Three-year Beta and Standard Deviation



Source: FactSet. Raymond James Ltd. Data as of March 31, 2023.

Final Thoughts

Low-beta stocks can offer retail investors stability and capital preservation during periods of heightened market volatility. By adding low-beta and volatility information to their stock selection criteria, investors can create a diversified investment strategy that weathers economic storms while targeting long-term financial goals.

Peter Tewolde
Senior Equity Specialist

ETF and Mutual Fund Flows

One way to gain a better sense of market sentiment and behaviour for each asset class and sector is to analyze fund flows. This practice can help investors understand which asset classes are popular and how they are positioning their investments. Over the previous three months (January 1, 2023 to March 31, 2023), the top inflows were led by fixed income categories and were fairly aligned with each investment vehicle. For mutual funds, the top categories include **Multi-Sector Fixed Income**, **Canadian Money Market** and **Global Fixed Income**. Whereas for ETFs, the top categories include **Canadian Money Market**, **Multi-Sector Fixed Income** and **International Equity**.

Mutual Fund Flows

Fixed income funds continued to top the inflow leaderboard, and investors have recently leveraged funds within the multi-sector fixed income and global bond categories to take advantage of opportunities across the entire fixed income spectrum. While there are many passive ETF strategies one can leverage to construct a Multi-Sector Fixed Income portfolio, outsourcing this sleeve to a dedicated and experienced fixed income manager can be valuable. In addition to flows in multi-sector/global bond strategies, money market strategies continue to direct flows, suggesting a nervous sentiment in the market.

Leading Categories for Three-month Mutual Fund Flows vs. Comparable Three-month ETF Flows

Rank	Category	Funds ($M)	ETFs ($M)
1	Multi-Sector Fixed Income	3,405	2,636
2	Canadian Money Market	2,843	3,343
3	Global Fixed Income	2,315	505

Source: Morningstar, Raymond James Ltd. Data as of March 31, 2023.

ETF Flows

Similar to mutual funds, ETFs have experienced an increase in flows into fixed income strategies over the previous three months. HISA ETFs (the main driver in the Canadian Money Market category for ETFs) continue to rake in money with over $3 billion in inflows over the previous three months. In addition, ETFs in the Multi-Sector Fixed Income category have received positive flows as investors look to diversify their fixed income exposures similar to mutual fund flows. Lastly, the International Equity category experienced a high volume of inflows over the past three months. Upon further analysis, it appears the recent inflow into this category was principally driven by a large institutional trade in the **BMO MSCI EAFE Index ETF** (**ZEA.TO)**, receiving over $1 billion in inflows over the previous three months.

Leading Categories for Three-month ETF Flows vs. Comparable Three-month Mutual Fund Flows

Rank	Category	ETFs ($M)	Funds ($M)
1	Canadian Money Market	3,343	2,843
2	Multi-Sector Fixed Income	2,636	3,405
3	International Equity	1,842	(828)

Source: Morningstar, Raymond James Ltd. Data as of March 31, 2023.

YTD ETF and Mutual Fund Flows

Category	ETFs ($M)	Funds ($M)	Combined ($M)
Canadian Money Market	3,343	2,843	6,186
Multi-Sector Fixed Income	2,636	3,405	6,041
Global Fixed Income	505	2,315	2,820
Global Corporate Fixed Income	566	1,543	2,109
Canadian Long Term Fixed Income	1,373	608	1,982
Global Equity	348	1,630	1,978
Canadian Fixed Income	888	706	1,593
Financial Services Equity	1,301	47	1,349
International Equity	1,842	(828)	1,014
Canadian Corporate Fixed Income	153	832	985
High Yield Fixed Income	502	465	967
US Money Market	306	540	846
Sector Equity	585	(57)	528
Global Infrastructure Equity	1,058	(599)	459
Energy Equity	150	79	228
Greater China Equity	126	33	159
Real Estate Equity	71	45	116
Global Small/Mid Cap Equity	(12)	94	81
Emerging Markets Equity	271	(221)	49
Natural Resources Equity	120	(73)	47
Canadian Inflation-Protected Fixed Inc	(4)	47	44
Commodity	(57)	(29)	(86)
Precious Metals Equity	(29)	(62)	(91)
Global Equity Balanced	227	(392)	(165)
Canadian Small/Mid Cap Equity	(5)	(276)	(281)
Preferred Share Fixed Income	(182)	(127)	(310)
Floating Rate Loans	(207)	(208)	(415)
US Small/Mid Cap Equity	(103)	(355)	(458)
Emerging Markets Fixed Income	(408)	(150)	(558)
Canadian Dividend & Income Equity	406	(1,305)	(899)
European Equity	(52)	(891)	(943)
Canadian Short Term Fixed Income	(990)	(227)	(1,217)
Canadian Equity	(216)	(1,201)	(1,417)
Canadian Fixed Income Balanced	(18)	(1,632)	(1,650)
Global Neutral Balanced	122	(2,695)	(2,572)
US Equity	(1,012)	(1,730)	(2,742)
Global Fixed Income Balanced	29	(2,969)	(2,940)

Source: Morningstar, Raymond James Ltd. Data as of March 31, 2023.

Additional Thoughts

Despite the recent volatility seen in U.S. financials, there was a significant $1.47 billion inflow into financial services ETFs in the month of March alone (led by **ZEB.TO, XFN.TO** and **ZUB.TO**). While it appears investors have been taking advantage of the recent volatility and uncertainty within financials, it is also interesting to note that we continue to see strong positive flows into ultra-low-risk money market strategies, such as HISA ETFs.

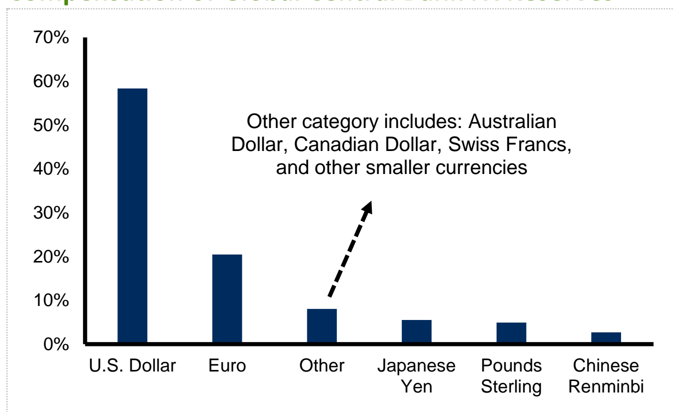
Luke Kahnert, MBA, CIM
Mutual Fund and ETF Specialist

USD Weaponization and De-Dollarization

"Every night I ask myself why should every country have to be tied to the U.S. dollar for trade? Why can't we trade in our own currency?" While statements like these from Brazilian President Lula da Silva have been echoed over the years by various leaders, the frustration and yearning for alternatives have been greatly amplified since the onset of the Russia/Ukraine conflict. Led by the United States and its Western allies, the invasion triggered a tsunami of financial sanctions against Moscow. Collectively, these sanctions cut off the Russian central bank, financial institutions and certain individuals from making transactions in U.S. dollars. The sanctions also removed major Russian banks from the SWIFT banking system, which serves as the vital backbone facilitating international payments.

It comes as no surprise that this so-called "weaponization" of the U.S. dollar has bolstered economic ties between Russia and China. It even prompted other nations to accelerate their efforts to reduce their dependence on the dollar and seek alternatives. While China has been proactively drawing down its coffers of U.S. Treasury bonds for several years now, it has seemingly put itself at the centre of this global de-dollarization push and accelerated efforts to cement trade deals with other nations, underpinned by the Chinese yuan instead of the dollar. In the midst of these developments, one thing is clear, the weaponization of the U.S. dollar through the aggressive use of sanctioning power is only going to increase this global de-dollarization push.

Compensation of Global Central Bank FX Reserves



Source: IMF.org; Raymond James Ltd.; Data as of Q4/2022.

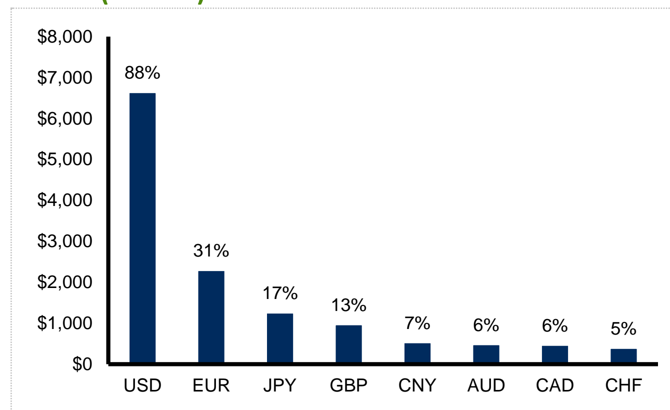
Coming for the Throne

As U.S. Treasury Secretary Janet Yellen eloquently stated, "There is a risk when we use financial sanctions that are linked to the role of the dollar, that over time it could undermine the hegemony of the dollar." So are we witnessing the demise of the U.S. dollar hegemony? We do not believe so. The U.S. dollar has remained on the throne since 1944, when it officially became the global reserve currency, following the Bretton Woods agreement. And, while there has been an increasing shift away from the dollar, dethroning the dollar as the world's primary reserve currency will not be an easy feat. Collectively, global central banks still hold roughly 60 per cent of their foreign exchange reserves in dollars, with euros coming in at a distant second with ~20 per cent. Therefore, even if other currencies begin to gain traction in underpinning trade and settlement, replacing the U.S. dollar in this capacity is no easy battle.

De-Dollarization and Threats to U.S. Dollar Hegemony

The weaponization of the dollar has been a primary tool in Washington's arsenal for quite some time (e.g., Cuba, North Korea, Iran, Venezuela, Russia, etc.). While we do not see a threat to the dollar's status as the global reserve currency anytime soon, there is certainly a handful of strategic players vying for dominance in the long run. Continued wielding of the dollar as a weapon in international and diplomatic conflicts may very well be the impetus needed for more countries to continue deviating away from the dollar and make way for a more multi-currency global reserve system.

Average Daily Turnover and Percentage Share of FX Trades (billions)



Source: BIS.org; Raymond James, Ltd.; Data as of Q4/2022.

To realize just how dominant the U.S. dollar is in our world today, according to the latest BIS Triennial Central Bank Survey, turnover in global foreign exchange markets averaged $7.5 trillion per day in April 2022, of which the U.S. dollar was on one side of 88 per cent of all trades. So, given the fact that a majority of global FX reserves are held in dollars, along with the sheer strength and size of the U.S. economy, there is just no viable alternative that can replace this level of global integration.

Ajay Virk, CFA, CMT
Head Trader, Currencies

A Different Yield Calculation to Consider

The fixed income market has seen huge positive inflows, spurred by rising interest rates as central banks battled stubborn inflation. Using ETF and fund flows as a proxy, fixed income categories advanced towards the top of the list, with Canadian Money Market and Canadian Fixed Income categories sitting one and two in net positive inflows over the last six and 12 months (broader quarterly flow data can be found in the Mutual Funds and ETFs section). With many investors returning to fixed income due to the resurgence of attractive yields, we wish to call your attention to discounted bonds and the unique opportunity they could offer for taxable accounts.

Discounted bonds, for the most part, are bonds issued years ago when rates were a lot lower and thus, had lower coupon rates attached to them. With the current rise in rates, these bonds, which were originally issued at $100.00 in price, are now trading at a discount (below par) to maintain their appeal to investors and offer a competitive yield. Since the coupon on such securities is so low, their price must fall further to equate to today's rates. As a reminder, a bondholder's yield to maturity is a blend of both the coupons received over the holding period and the increase or decrease in the value of the bond vs. maturity value. To investors allocating new money to this asset class, discounted bonds present a unique opportunity that should be considered for taxable accounts.

Tax rates differ between capital gains and interest payments, where capital gains receive a more favourable tax treatment. Given this, if you are buying a coupon-paying bond in a taxable account, it often makes sense to buy a discounted bond instead of a GIC or bond priced at or higher than $100 to receive the tax benefits of a capital gain. At first glance, the absolute yield to maturity may be higher for a non-discounted instrument, but it doesn't mean that after taxes, it is a "better" yield for your portfolio. Note that capital gains treatment does not apply to zero coupon instruments such as treasury bills and strip bonds.

The chart below shows various issues displaying their quoted yields, but more importantly, the after-tax yield and pretax equivalent yield for a bond priced at par based on a 50 per cent interest income tax rate and 25 per cent capital gain rate. All clients have a tax rate that is individual to them, but these calculations help illustrate the effect that tax can have on one's effective yield. To summarize the effect, generally, as the percentage of your returns coming from capital gains rises compared to interest income, so do your after-tax returns.

Before purchasing fixed income in taxable accounts, make sure to consider this different yield calculation – the product's after-tax yield. Although another investment may have a higher coupon or even pre-tax yield, diving into the sources of income may prove worthwhile.

As our department does not provide tax advice, always consult an accountant to see if this strategy works for your individual portfolio. If this is something you want to consider, then speak with your financial advisor for options that may suit your individual needs.

Harvey Libby
Head Trader, Fixed Income

Taxes Have a Large Impact on End Returns

	1 Year GIC	Prov. Sask. 0.80% Sept 2, 2025		Laurentian 1.15% June 3, 2024		GoC 0.25% April 1, 2024	
Price	$100.00	$93.50		$96.00		$96.55	
Pre-tax Yield to Maturity (annual equivalent)	4.81%	3.75%		4.97%		4.10%	
	Interest Income	**Interest Income**	**Capital Gain**	**Interest Income**	**Capital Gain**	**Interest Income**	**Capital Gain**
Net monies received	$48.10	$19.88	$65.00	$18.46	$40.00	$2.33	$34.50
Taxes paid	$24.05	$9.94	$16.25	$9.23	$10.00	$1.17	$8.63
After-tax income	$24.05	$58.69		$39.23		$27.04	
After-tax yield	2.41%	2.60%		3.40%		3.01%	
Par bond equiv. yield	4.81%	5.20%		6.80%		6.02%	

Source: Raymond James Ltd. Values based on 1000 face maturity value with settlement of April 26, 2023. Informational purposes only. Estimates using 50% interest income tax rate, 25% capital gain tax rate. Individual tax rates will vary and thus affect after-tax yields achieved.

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