Sell in May and go away?

May 2019

The strong performance of risk assets year-to-date has increased focus on the potential returns from a "sell in May and go away" strategy. We explain why such an approach may not be warranted this year for investors in emerging market currencies.

Will lightning strike again?

"Sell in May and go away" is a phrase that originates from the historical observation that US stock markets have tended to rise most between the months of November to April. In particular, May is cited as a frequent turning point for a period of negative performance in risk assets.

TABLE 1: AVERAGE MONTHLY PRICE RETURN PER DECADE FOR S&P 500 (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	May-Oct return	Nov-Apr return
1960-1969	0.94	-0.63	1.03	1.79	-1.20	-1.89	0.53	0.78	-0.39	1.68	1.74	0.65	-0.48	5.52
1970-1979	1.24	0.11	1.38	-0.06	-1.53	0.59	-0.35	0.20	-0.80	-0.46	0.27	2.27	-2.35	5.20
1980-1989	3.38	0.58	0.34	1.67	0.83	1.58	0.58	2.48	-1.26	0.41	1.76	0.90	4.63	8.65
1990-1999	1.62	1.53	0.79	1.34	2.41	0.61	1.26	-2.18	0.83	1.77	2.31	2.95	4.69	10.54
2000-2009	-1.75	-2.85	1.43	2.26	1.32	-1.48	-0.51	0.90	-2.36	0.08	0.88	0.63	-2.04	0.60
2010-2018	0.40	2.27	1.70	0.92	-0.64	-0.43	2.28	-1.23	0.56	2.32	1.43	0.21	2.85	6.94
Average	0.97	0.17	1.11	1.32	0.20	-0.17	0.63	0.16	-0.57	0.97	1.40	1.27	1.22	6.24

Source: Bloomberg, J.P. Morgan Asset Management; data as of 30 April 2019. Past performance is not a reliable indicator of current and future results.

It is not the case that stock returns in the period May to October have been particularly negative historically (Table 1 shows that on average they have been positive). However, returns have lagged those recorded in November-to-April periods on average.

Whether this historical observation will continue to hold into the future is the subject of much debate. There are those who argue that one cannot draw statistically significant conclusions from this analysis, while others will argue that the market is efficient and once a profitable statistical pattern is recognisable, it will be meaningfully arbitraged away in subsequent years. 'Seasonality' divides investors like few other investment strategies, and shifting investor preferences and flows certainly provide good reason not to rely on past seasonal patterns to predict future returns.

Emerging market currency performance has historically been positively correlated to risk asset sentiment because of the pro-cyclical drivers of emerging market returns (commodity prices, the global export cycle etc). Therefore, it would make sense if historical returns on emerging market currencies displayed much of the same seasonality as stock market returns. Table 2 shows that this is indeed the case.

May has been a particularly challenging month for emerging market currency performance in recent years as a number of identifiable negative market events (the Greek debt crisis, the taper tantrum, Italian political instability etc.) have promoted US dollar strength and emerging market currency weakness. However, although lightning may have struck in May several times, there is no specific reason to anticipate another lightning strike this year. Also, as a number of market stresses that have occurred in May in recent years have originated in the Eurozone, it is notable that May does not represent the weakest month of emerging market currency returns when funded out of euros.

TABLE 2: TOTAL RETURN ON BASKET OF EMERGING MARKET CURRENCIES FUNDED OUT OF US DOLLARS (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	May-Oct return	Nov-Apr return
2003-2008	0.08	1.04	-0.15	0.97	-0.23	-0.04	0.80	-0.15	1.70	1.50	1.83	1.24	2.08	6.51
2008-2013	-0.20	0.92	1.28	2.36	-1.19	1.38	2.01	-1.17	-1.06	-1.05	-1.32	0.92	-0.02	2.91
2013-2018	-0.88	0.88	1.44	1.48	-1.64	0.56	-0.35	-1.09	-0.65	0.46	-1.85	-0.75	-3.16	0.78
Average	-0.33	0.94	0.86	1.60	-1.02	0.63	0.82	-0.80	0.00	0.31	-0.45	0.47	-0.06	3.10

Source: Bloomberg, J.P. Morgan Asset Management; data as of 30 April 2019. Past performance is not a reliable indicator of current and future results.

Valuations and fundamentals remain supportive

We believe the backdrop for risk asset performance remains supportive. Global growth is recovering from the downturn at the end of 2018, and central banks globally have shifted to a more accommodative stance, which is likely to be maintained for some time given weak global inflation pressures. Stock market performance has been strong year-to-date, although this has not been matched by emerging market currency returns, where aggregate total returns are disappointing at only ~+1% year to date.

Reflecting these mediocre returns, we do not believe speculative long positioning in emerging market currencies is excessive and hence we are not entering May from a starting point of stretched valuations or positioning. It is also the case that emerging market currency fundamentals are, on aggregate, relatively sound compared to previous years (for example, external balances are healthy) and we anticipate future positive news on China/US trade negotiations and further evidence that Chinese stimulus measures are starting to promote stronger levels of Chinese growth. This backdrop should prove supportive for emerging market currency outperformance, with higher yields also attracting portfolio flows set against a backdrop of low yields in developed markets.

We are therefore cautious on the “Sell in May and go away” strategy as it relates to emerging market currencies in 2019 from a statistical, valuation and fundamental perspective. Instead, we prefer to position for emerging market currency outperformance against a diversified funding basket of developed currencies to help guard against further unanticipated US dollar strength.

Currency Management

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- Dynamic 'intelligent' currency hedging aims to reduce currency volatility from the underlying international assets and add long-term value over the strategic benchmark. A proprietary valuation framework is used to assess whether a currency looks cheap or expensive relative to the base currency and the hedging strategy is adjusted accordingly.
- Active 'alpha' currency overlay strategy offers clients' passive currency hedging, if required, combined with an active investment process to deliver excess returns relative to the currency benchmark. Our approach is to build a global currency portfolio combining the output of fundamental models and incorporating the qualitative views of our strategy team.

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