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"Sell in May" on Pause Due to Broadening Market Rally

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It's a sure sign of market confusion when the performance table is topped by both the riskiest *and* the safest asset classes. Such was the case in May, which saw emerging market equities surge 3.5% while long U.S. Treasuries delivered an impressive 3.0% return. Meanwhile, a positive month for a cross section of global asset classes makes an investment adage like "sell in May and go away" seem, well, risky.

European Monetary Stimulus on Deck

Being a seller in May was made even more risky thanks to dovish comments by the European Central Bank (ECB), which suggested it was likely to enact stimulus — such as cutting commercial interest rates, reinstating its long-term refinancing operation (LTRO) or, more vaguely, Mario Draghi's "whatever it takes" — at its June 5 meeting in an effort to counter deflation.

A brief history of the impact of prior ECB stimulus may be helpful for May's sellers. In December 2011 the ECB initiated its first round of LTRO with little fanfare, and global markets exploded on its rollout, catching bearish investors by "surprise" despite the advance warning (thus relegating another adage — "buy on the rumor and sell on the news" — to the recycle bin). To add insult to injury, investors ignored the announcement of a second tranche of LTRO, to be initiated in February 2012. Sure enough, another half a trillion euro refinancing was initiated on February 29 and markets leaped on cue, again "surprising" a certain segment of investors.

The latest ECB stimulus effort — announced June 5 as we go to press — surpassed expectations with an "all-of-the-above" approach; the central bank cut the deposit rate to negative, sliced its main lending rate to 0.15% from 0.25%, launched another round of LTRO and more. The announcement initially has seemed unappreciated by global markets, which could represent an opportunity for investors. The other side of the coin, however, is that ECB action may have been priced into bonds this time, as evidenced by the remarkable drop in the sovereign yields of former PIIGS Italy and Spain, which have seen the interest rates on their debt decline from a four handle to 3.00% and 2.86%, respectively — not that far from the ten-year U.S. Treasury, the global reserve currency.

Regardless, new stimulus joins fundamental economic strength as arguments against "sell in May".

U.S. Fundamentals Picking Up

The U.S. economy received affirmation from the Commerce Department that the first quarter was indeed miserable, as the second GDP estimate showed a contraction of 1% and gave credence to all of those who were bemoaning the polar vortex. But the first quarter is long behind us, and more recent data paint a much improved picture for the second quarter.

Manufacturing is accelerating. The most recent ISM manufacturing index number of 55.4 is the highest this year and represents the fourth straight month of increasing expansion. The manufacturing recovery has been uneven geographically, with the South and Midwest benefitting disproportionately; in fact, some of these regional indices were absolute blowouts, including the Chicago PMI reading of 65.5. In the Midwest, cheap

Executive Summary

- Strong performance of both emerging market equities and long Treasuries during May suggests confusion among investors.
- Mario Draghi delivers on "whatever it takes" ECB easing.
- Though first quarter U.S. economic growth was miserable, more recent data suggest acceleration is underway.
- Broadly diversified portfolios obviate the need for clichés like "sell in May and go away".

A Broad Cross-Section of Markets Moved Higher in May

Index	May-14	YTD
Equity		
S&P 500	2.3	5.0
S&P MidCap 400	1.8	3.2
S&P SmallCap 600	0.3	-1.4
Global REITs	3.1	10.2
EAFE	1.8	4.1
Emerging Mkts	3.5	3.5
Fixed Income		
Corporate	1.4	5.6
U.S. Treasury 20+	3.0	13.4
Global Aggregate	0.6	4.2
High Yield	0.9	4.6
Senior Loans	0.5	1.7

Source: FactSet, FTSE NAREIT, Voya Investment Management energy has helped automotive plants, while many states in the South are using their low-cost labor force and right-to-work status to gain advantage. Headlines are dominated by new and exciting developments like the expansive energy complex in Louisiana that will cost $21 billion and require 7,000 workers at its peak; Louisiana, a state with annual GDP of around $250 billion, will see $90 billion in new industrial projects in the next five years.

Consumer confidence ticked up in the latest reading. But jobs are the key ingredient needed to keep consumers spending, and the trend here has been positive as well. Initial unemployment claims are moving decidedly downward; the 13-week average of unemployment claims — which provides a smoother picture than the volatile weekly number — has declined 6.4% over the past 13 weeks to reach its lowest level since October 2007. In contrast, February saw this average up 2.4% over the prior 13 weeks.

While the unemployment rate has dropped to 6.3%, many of the 857,000 nonfarm payroll jobs created this year were in low-paying service industries. The resurgence of the higher-paying manufacturing industry — particularly the energy sector — is poised to alter this trend. On average, the oil & gas industry provides an employment multiplier greater than three; this means that for every direct job created in the oil, natural gas and related industries, three or more indirect and induced jobs are also created.

Housing is undoubtedly a lift to consumer spending and their confidence in the U.S. economy. Home prices are now 12.4% higher than they were a year ago according to the S&P/Case-Shiller 20-city home price index. Existing home sales ticked up 1.3% in April, the fastest pace since December; more important, pending home sales, an indicator of future activity, were up for the second month in a row. Housing starts also surged in April, to an annual rate of 1.072 million homes. The housing market slowed going into the end of 2013 as interest rates went up and falling inventory levels gave buyers fewer choices. However, this has turned around. Mortgage rates are down more than 50 basis points since September, while the number of existing homes on the market jumped 17% in April. Additionally, credit is easing; last week, the Federal Housing Finance Agency announced that it is taking technical steps to make mortgage lending easier for banks. Already the average credit score for loans acquired by Fannie Mae in the last year has declined 16 points, to 741, and the portion of loans made to borrowers with sub-700 FICO scores is nearly 17%, an increase of 7% compared to first quarter 2013.

Corporate profits are the funnel for these economic data points, and for all of the weather-related lamenting in the first quarter, earnings surprised on the upside. Year-over-year growth in both earnings and revenues exceeded 2% last quarter, not too shabby given a backdrop of negative 1% economic growth. Expectations for the rest of the year are significantly higher.

Frontier Markets Have Been Notably Strong Year to Date

Index	Currency	May-14	YTD	2013	2012	2011	2010	2009	2008	1 Year	3 Years	5 Years
Global Markets												
MSCI Frontier Markets	USD	6.1	20.7	26.3	9.2	-18.4	24.2	11.7	-54.1	29.2	12.5	11.7
Select Countries												
Peru	USD	-0.1	11.5	-29.8	20.2	-21.4	53.3	72.1	-40.1	-0.8	-3.8	8.8
	local	*-0.1*	*11.5*	*-29.8*	*19.7*	*-21.4*	*53.3*	*69.0*	*-38.9*	*-0.8*	*-4.0*	*8.7*
Turkey	USD	9.9	23.9	-26.5	64.9	-35.2	21.2	98.5	-62.1	-14.3	2.0	12.4
	local	*8.7*	*20.8*	*-11.5*	*55.8*	*-20.4*	*24.5*	*92.8*	*-50.1*	*-4.4*	*11.6*	*19.5*
Oman	USD	4.1	5.4	15.9	-6.5	-12.5	17.9	26.6	-45.2	7.8	4.0	6.6
	local	*4.1*	*5.4*	*15.9*	*-6.5*	*-12.5*	*18.0*	*26.6*	*-45.2*	*7.8*	*4.0*	*6.6*
Vietnam	USD	1.7	13.7	7.2	18.9	-38.1	10.4	31.7	-57.1	5.2	1.7	3.3
	local	*2.0*	*14.0*	*8.5*	*17.8*	*-33.3*	*16.5*	*39.2*	*-53.1*	*5.9*	*2.7*	*7.0*
Indonesia	USD	0.4	23.4	-23.1	5.2	6.5	34.6	127.6	-56.2	-14.7	-1.4	17.3
	local	*1.4*	*18.4*	*-2.9*	*11.8*	*7.2*	*29.1*	*96.2*	*-49.2*	*1.7*	*9.5*	*20.3*
Kenya	USD	0.3	12.2	48.2	62.8	-26.8	30.8	6.9	-37.2	14.5	27.2	27.2
	local	*1.1*	*14.1*	*48.6*	*64.7*	*-22.8*	*39.2*	*3.7*	*-23.0*	*17.9*	*28.1*	*30.1*
S&P 500		2.3	5.0	32.4	16.0	2.1	15.1	26.5	-37.0	20.4	15.1	18.4

Source: FactSet

Emerging Markets Led the Way in May

Emerging markets are generating excitement in Asia, Africa and the Middle East. Savvy investors are adjusting accordingly, and these investors tend to be very different than the safe-haven investors that have driven bond yields lower, hence the bifurcation in performance that we discussed in the opening.

Frontier markets are up more than 20% year to date and more than 6% in May alone. Indonesia, one of last year's "fragile five", is among the global year-to-date leaders with a return of 23% in U.S. dollar terms. The country's economic crisis of 2013 was swiftly undone by an interest rate hike and an improvement in its significant trade deficit; as a result, forecasts for Indonesian corporate profits are moving higher, raising expectations for even more market gains.

Meanwhile, India's key equity indexes — the Nifty and Sensex — hit records highs in the weeks prior to the election of India's prime minister, with each rising about 20% since mid-February. Now that reform minded, pro-business Narendra Modi is in office, the government's focus will be on unlocking India's massive economic growth potential; the country grew only 4.7% in 2013, its second year of sub-5% growth.

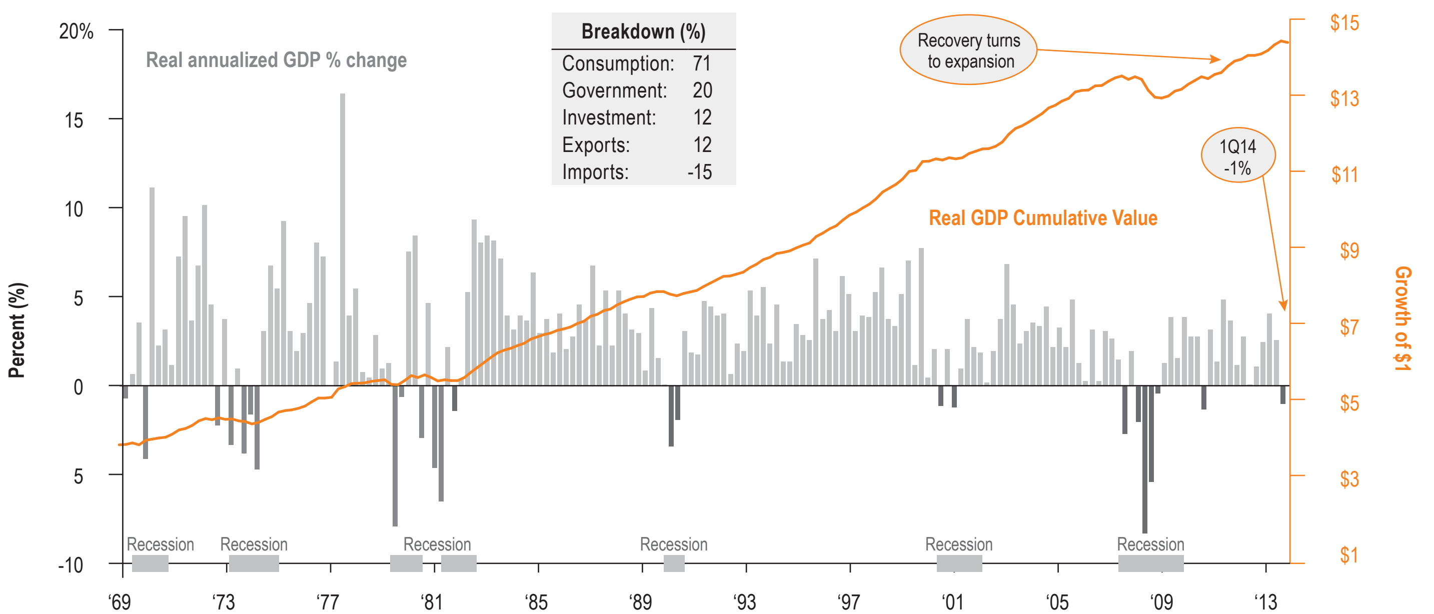
In the Middle East, Dubai's DFM General Index is up 50% year to date, in part due to the United Arab Emirates' promotion into the MSCI Emerging Markets Index from frontier market status. Qatar was also included in this reclassification, and it has rallied 27% year to date. Interestingly, Greece (up more than 3%) was also moved into the emerging market index, having been downgraded from developed market status by MSCI at the end of last year. Meanwhile, South Korea and Taiwan may soon be reclassified as developed markets.

Frontier markets are a Global Perspective "tectonic shift" and merit close attention as they transition to emerging and ultimately developed markets.

The Folly of "Sell in May"

Investment adages are not truisms; they are merely intended to simplify long-term trends that seem to repeat but are not necessarily actionable. "Sell in May" presumes to divest assets with very different risk and return characteristics while disregarding the important roles they play in a diversified portfolio. In the Global Perspectives 2014 forecast we highlighted an array of assets that belong in an effectively diversified portfolio, including (in order of year-to-date return) global REITs, emerging markets, mid-cap equities and senior loans. There's no need to resort to hoary old clichés when you incorporate assets like these in an effectively diversified portfolio that builds wealth and controls risk 12 months a year.

First Quarter GDP Was Bleak, But Momentum Is Building



Source: Bloomberg

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