Dave's Diary

July 2008

As I write this in the closing days of July the TSX Composite Index has managed to close at progressively lower levels for seven consecutive weeks. South of the border the S&P500 has not retreated quite as linearly but its total percentage decline since early-June has been right in-line with that of the TSX at roughly -11% over the same period of time. Folks, welcome to the *summer correction*.

I have never been a huge advocate of technical analysis (the study of chart patterns) but among the real and imagined patterns that exist the phenomenon of a general market sell-off in the early summer months is an interesting one that does seem to recur fairly regularly. It is this regularity that has given rise to the old adage that advises investors to "sell in May and go away". For many who follow this advice, the norm is to get defensive (ie. move partially or entirely to cash) in May or June and to remain there until September. This strategy could potentially have worked for the past two years and so far in 2008 it is *looking* like it could work again. That said, the letter of the strategy actually calls for selling on May 1st and re-entering the market on October 31st, in effect, sitting out the weakest half of the year and investing in only the strongest half. Looked at on this basis, the phenomena is quite pronounced, with the November-April period frequently outperforming the May-October period in most of the world's major markets. *Why* this effect occurs has been studied on numerous occasions but without conclusive findings. Intuitively it is often felt that individuals going on vacation and otherwise occupying their time while the weather is nice is the key driver behind the effect, but in parts of the world where the seasons run opposite to those in the northern hemisphere (like Australia) the chart patterns are no different, leaving analysts scratching their heads.

What can we learn from this? Should everyone be investing only six months out of the year? On the face of it this strategy might seem to increase one's odds of investing success, and this seems to be especially true if one's portfolio is set-up to track the market index. Where things become less clear is when one isn't tracking the index and is either holding a comparatively small number of individual stocks and/or actively-managed mutual funds. While the November-April period is generally a stronger one than the May-October period, this applies to the broad market. Individual stocks are not nearly as consistent in terms of their strength and weakness patterns and the number of holdings in the average stock investor's portfolio is not a broad enough sampling of the market to ensure that the pattern affecting the market index will hold-up among their much smaller basket of securities.

In the end, the "sell in May…" effect is real and it is worth noting. Whether any given investor should act on it and to what extent really comes down to one's personal situation and objectives, but for most it would probably not prove to be consistently advantageous. For those who have remained fully-invested through the current market weakness, the best advice in most instances is to sit tight, as these cycles never continue in one direction indefinitely and staying invested is the only way to participate fully in the eventual recovery. Last year at this time we were in the thick of a similar correction that ran about 6 weeks to the middle of August with a similar total drawdown of roughly -12% on the TSX. While this is no guarantee that we have now seen the bottom of the current summer pullback, what *is* worth noting is how sharply the market bounced last summer in the very short time following the market bottom. The market reached its low about mid-August and by the end of that month was already more than one-third of the way back to recouping its *total* value as at the time correction first started in July (it took roughly another four months to recover fully).

In conclusion, the lesson is that the best approach to achieve portfolio recovery as quickly as possible once caught in a market correction *is* to stay the course.

My Very Best Regards,

Dave Hagenow