Manulife Investment Management

Investments Unplugged Ep 84

Macan Nia:

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Kevin Headland:

Dude, I was just in Quebec City for last three days, so my brain is still speaking in French or thinking in French.

Macan Nia:

We'll use that as the excuse.

Kevin Headland:

Yeah.

It is often said that death and taxes are the only guarantees in life, but there are many things that we have become used to expecting each year with almost certainty: holiday music and shopping malls starting well before many are ready to hear it, the silent cheering by parents as kids go back to school following summer break, and the dread of filing income taxes in the spring.

When it comes to financial markets and our roles, there always seems to be the same issues that occur year after year that come up in conversations. It may be about trading strategies that seem to dominate headlines at different times of the year, or recurring subjects that make investors uneasy every time they appear in the news.

On today's episode of Investments Unplugged, we take a look at some of these popular topics to help explain them and what, if anything, should be done from an investor's point of view. Spoiler alert, it is more often much to do about nothing. Listen on. This is Investments Unplugged.

Welcome back to Investments Unplugged. As always, I'm your co-host, Kevin Headland, Co-Chief Investment Strategist at Manulife Investment Management. And with me is Macan Nia, as always. Welcome, Macan.

Macan Nia:

Hey, Kev.

Kevin Headland:

How's it going?

Macan Nia:

Not bad. Did you forget your title there for a second?

Kevin Headland:

Dude, I was just in Quebec City for the last three days, so my brain is still speaking in French or thinking in French.

Macan Nia:

We'll use that as the excuse.

Kevin Headland:

Yeah. I've got lots of excuses. It's always good. Anyways, before we get started today, I've got a great story for you. So a few episodes ago, we talked about ChatGPT and AI and whatnot, and we did mention how some students may be looking at using this to produce essays and whatnot. Well, one of our advisors and friends of ours and regular listeners, his son and a couple of friends were listening to the podcast in the car with the advisor and lo and behold, a few weeks later he gets a note home from the kids' school and apparently the kids used ChatGPT to produce a paper and got caught. So it's quite funny that they did this. I hope it wasn't because of us. We did warn people not to use it. But it is interesting how already we have an example of someone we know, that a child used it and actually got caught. So beware out there any kids listening. Do not use ChatGPT or any other AI software to try and cheat on your essays or exams.

Macan Nia:

Kev, what I find very comical about this story is Nathan listens to the podcast when he takes his kids to school or to, I think they're in soccer or lacrosse. And of all the things that they took away from that podcast, because I think there was a lot of value-add, they took away... And typical boys. At that age, I think they're in grade seven, grade eight, all they took away with it is how to make my life easier and how I can get out of doing work. So yeah, leave it to elementary school boys to do the unexpected.

Kevin Headland:

Yeah. It was quite funny. It was a prep school, and they even sent an email home to all the parents talking about using it for essays and tests and exams or whatever. So it was quite funny of just a real world example, close to home, of Chat GPT uses already.

Macan Nia:

I just didn't like how we introduced a negative influence on it, but anyways, we'll try to do better moving forward.

Kevin Headland:

Well, we try and more people come on. We can only do so much. But anyway, today it's actually almost kind of a similar, I don't want to say warning, but we're going to discuss a few things that seem to come up every year or every couple of years. We get the same questions around the same time talking about certain headlines, and often our same response is, "It's much to do about nothing. This is a regular occurrence. Avoid the headline news. It's not a trading strategy or we shouldn't make investment decisions based on the short-term news." And the first one, of course, is the very popular subject right now of the US debt ceiling.

Macan Nia:

So Kev, let's take a little bit of a step back. Right now, we're recording this on May 18th, and as of right now what's happening in Washington, and it just shows you how little I pay attention to anything related to this, I think where we are today is that the Republicans have basically passed the bill to raise the debt ceiling. But they've also tacked on a provision that would require, I think it's close to $5 trillion in spending cuts over a decade. This has obviously been rebuffed by the Democrats. They're arguing that spending cuts and raising the debt ceiling are two different bills. But you know what's happening. The Republicans are hoping that a sense of urgency will kind of allow them to receive additional concessions like they did in 2011.

Kevin Headland:

Well, again, it's the old story. Of course, we know that the debt ceiling has been raised, what, over a hundred times in its history. This happens usually every couple of years. Sometimes we don't even hear about it because it is just a temporary increase through executive order, but eventually you actually have to get a budget passed and a resolution passed to increase it. This is where it happens. And Treasury Secretary Janet Yellen has talked about the specific day when the US government will run out of money, and whether it's June 1st or in August or July, it's a lot of uncertainty.

But the whole idea here is it doesn't help anybody. Everyone wants to get debt ceiling resolution. But as you mentioned, each party is not going to make it easy for the other one to be able to pass it. Everyone wants their own, I don't want to say piece of flesh or whatever, but for lack of a better term, they want to make sure that they benefit from it, especially going to an election next year. And it's uneasiness is always headline news, but it always gets resolved even if there's furloughs involved, even though there's furloughs involved. And you had a great chart recently, and we posted it on LinkedIn, about the average length of furloughs and whatnot.

Macan Nia:

Yeah. This is a Washington tradition. So we look back since 1980, there's been 10 US government shutdowns involving furloughs, and on average they lasted nine days. Now of the 10, it's interesting, Kev, the first five, they were resolved in basically a day and a half. And the last five have taken a little bit longer, roughly two weeks. And I think that just shows you the partisanship in Washington as of late.

But we were talking with this with Francis, and she came up with a quote which I thought was very comical and very true. And it's the fact that every new intern gets wildly excited about the US debt ceiling topic. And then, fast-forward four to five years and they're rolling their eyes at the new kids. So this is something, as I said, it's a Washington tradition. It has an impact on the markets in the very short term, but never has an impact over the medium. It's more of a disruptive event more than a destructive event.

Kevin Headland:

100%. And I think last time there was any material length of furlough was in 2018 in December. We can remember December 22nd was the debt ceiling date. The US government got shut down for, I think it was 35 days. And then, from early December through December 24th, December 24th, Christmas Eve was the bottom of the market that year. The S&P 500 was down like 16%, but then recovered in early 2019. And the round trip, point to point, so down 16 and recovered, was like 55 days. Again, very short term, really inconsequential to the overall path of the S&P 500. And I think it's important, as you said, it's really disruptive. It's headline news. Yes, it's important to look at it. But in the end, it's definitely not an investment strategy. You shouldn't be waiting for the market to fall because of this and then trying time it perfectly.

Macan Nia:

Kev, it's not important to look at. It doesn't matter. Let's move on. Every year it happens, then it's just noise. So let's move on to the next seasonality one. Do you want to go with "sell in May and go away"?

Kevin Headland:

Yeah, sure.

Macan Nia:

So life is unpredictable, but within this life there's some things that are always predictable, Kev. And we always joke about one good one is Christmas music. Every early November, you can guarantee that when you walk into wherever you shop that you're going to start hearing Christmas music. I think now it's probably September, it seems. It seems like Christmas starts in September.

Kevin Headland:

So I don't go into shopping malls or any stores. You just go online, you don't have to worry about it.

Macan Nia:

But it's an interesting one, is whenever May hits in the financial markets, or not markets, but in the media, you always get these "sell in May and go away" articles. And as a result, we get questions from advisors. So the history of "sell in May and go away" is actually interesting, in the sense that its origins go back to basically Old England when stockbrokers would go on summer vacation in May and they wouldn't return until basically the end of September. And the original saying was selling, "Sell in May and go away, and do not return until Saint," I hope I'm saying this right, "St. Leger's Day." And basically, what that was is it was the final horse race of the season happened on that day, and the old school stockbrokers didn't bother coming back to work until the race had ended or racing season had ended. Would have been nice.

Kevin Headland:

Sounds great.

Macan Nia:

Yeah, it sounds amazing.

Kevin Headland:

Off from May to October?

Macan Nia:

Yeah. Exactly. So that's the origins of it. And I think it has gained credibility too, Kev, because a lot of these big market sell-offs, the ones that we remember as investors, typically happen in this period that goes from May to the end of October. And I think it's given it a little bit more validity than the actual numbers suggest. So a couple of the big ones, Black Monday, the Great Financial Crisis happened throughout that period. I'm missing one now. There's a big one. Oh, the downgrade of the US debt in 2011, and that led to market volatility.

So we've done work on this, and Kev, maybe you want to go through what the data suggests in terms of whether you're better off just buying and holding or "sell in May and go away," which would imply that basically you sell your stocks at the beginning of May, you go into cash, you come back October 31st, and you hold for that next six month period. Actually, maybe do you want me to just go through it, because I have it?

Kevin Headland:

Yeah. You have it up in front of you. Go ahead.

Macan Nia:

So there's no surprise, Kev, for lack of a better word, it's garbage. That's a technical term. So when we looked at buy and hold versus "sell in May and go away," and let's look over the last 20 years. Buy and hold, it's 7.6% per year. "Sell in May and go away," 5.6%. So you've got 2% more per year, over 20 years, by doing buy and hold. And when you look at it from a shorter term perspective, 10 years, the outperformance of buy and hold versus sell in May is actually is much more pronounced. It's double. So 5.5% for "sell in May and go away," and buy and hold is almost close to 10.5%. So in a nutshell, it's not a trading strategy, it's just something interesting to talk about but holds no validity when it actually comes to an investment strategy.

Kevin Headland:

Yeah. It's a perfect example of it's a great story, it's a great little sound bite. It sounds nice, it rhymes. But again, using averages, especially of longer periods of time, can capture some material moves that really distort the overall message, because the average really distorts the data. And that buy and hold strategy most recently is a perfect example of that. So yeah, it's great.

And there's always, you said, always, every year there's some media outlet somewhere, multimedia outlets, talking about "sell in May and go away." It's a regular occurrence. And the data is always there. And yes, on the long-term it might outperform, but it's just not consistent, as you said. And if you do it, you could miss out on some really strong rallies. And we've seen really strong rallies in the summer over the last five years or so, and you would have missed these really strong markets. And you should be investing based on tangible fundamentals, not on "sell in May and go away" rhymes that don't really apply today, as you said. It's the old stock traders that used to go away and you had low volumes and you had movements because of that.

Macan Nia:

Yeah. And I don't think the purpose of these articles is to actually implement this trading strategy. I think all it does really create is, what every investor deals with, is noise. But given behavioral economics, if there's a negative connotation to it, it maybe increases the odds of an investor doing something that they probably shouldn't be doing. So if anything, it's noise, but I think it comes at the detriment of an investor's experience. Over the last 50 years, between that May and October period, which is supposed to be very negative, that's why you want to be in cash, it's actually only been negative 32% of the time. So 70% of the time during this period, market returns are positive.

And what I find interesting is over the last 10 years, this strategy would have just completely killed you, because we've had, I think it's 80% of the time over the last 10 years, the market performance was positive during this period, and the average return was 5%. So when we talked about that 10-year number where it's 10.5% basically for buy and hold, sell in May, it's like over the past 10 years, this strategy has really not worked.

So let's put this one to bed. All of these seasonal trading strategies are garbage, for lack of a better word. You know the AFC versus NFC, Dogs of the Dow. Go through the list, it's so on and so forth. All it does is, it's noise, it doesn't matter. Let's move on though, because there are some truths though, to seasonality. Depending on the time in the market, historically, some months are better for markets than others.

Kevin Headland:

Yeah. One of the ones we look at, of course, is a lot of people talk about the Santa Claus rally. The end of year and early the following year, so kind of those winter months in the Northern Hemisphere tend to be better for both the S&P 500 and the TSX, so both US and Canada. So they tend to be stronger. We have the Santa Claus rally in this. It originally came out of the Stock Trader's Almanac back in 1972, that there was a Santa Claus rally because there's a seven-day period leading through Christmas that markets tend to be strong, up 0.5%, from 1950 to 1971. So there's kind of this pattern that leading into the end of the year, leading into Christmas, markets are positive. And they called it the Santa Clause rally.

And there's multiple reasons perhaps for this, because maybe people are reinvesting after doing some tax loss selling. Perhaps it was bonus season and people were investing their bonuses. Some were perhaps getting in before the January effect, which tends to be markets rally early in the year in January. So it was quite interesting, calling it the Santa Claus rally. And it tends to be positive, those months of the year tend to be positive. But again, waiting for those months, it's again back to averages, right? Long-term average, yes. However, not every month, not every time does it work.

Macan Nia:

I wonder if some of that has to do with depending on the brokerage firm, they have end of year dates. Their grids start again, or their sales target or their revenue targets. And some of them for the more IIROC dealers, I think they end in November. Maybe that has something to do with it. So there's all these reasons, but when you look at the monthly returns, there's no doubt when you look at the S&P 500, November and December and January are very good months for the market. And in terms of the odds of being positive, the same, September historically is a very bad month for market in the US. It's the only month, Kevin, since 1950 that actually has a negative median return, whereas everyone else is positive and the odds of actually being positive are below 50%. The only month that has that.

TSX has some of those relationships, but it's not as pronounced as the S&P. But it goes back to that period where November, December typically very strong, January too, and the weaker months are your June-September periods.

Kevin Headland:

I think the odds of being positive really is important there, because it's another layer of looking at the averages. The averages, again, don't tell the whole story. But then you look at the potential of being positive, the probability of being positive, that gives you a bit more information on whether this is consistent or not. And as you said, I think September is the only month below 50% in terms of probability of being positive, going back since 1950. So definitely telling.

Of course, we don't unnecessarily always sell in September, but there is truth to that story and who knows why. It could be multiple different reasons, but it seems like at least that is one that seems the hold true through consistent time, that this is one of the months that has the least probability of being positive. And maybe it's one of those self-fulfilling prophecies. People have been following this data and saying, "Oh, September is bad, so I want to sell." And it gives a self-fulfilling prophesy because September's bad or the fundamentals are bad. It's just that maybe there's additional trading that happens because people are trying to recreate the idea that September is one of the worst, if not the worst, month of the year to be invested.

Macan Nia:

And it's just not actionable for a typical investor, a typical advisor.

Kevin Headland:

Oh, no.

Macan Nia:

That you're going to sell out going into September and then get back in. Think about how long of a process that requires. For most, it's not just a quick pressing of a button. It takes time. It's just things that, you know what? I think it's just fluff that we've seen in financial media.

And maybe we'll end, Kev, with volumes. So the argument is volumes dry up in the summer. And there's a lot of truth to that. So I looked at the last 20 years of data in terms of the top 20 months in terms of volumes, nearly 40% of them happened in March/April. I think a lot of that has to do with whether it's here at home in terms of RSPs, down in the South in terms of contributions to pensions. I think their date is mid-April, if I'm not mistaken. But it's all in this typical March/April period. Does that add to volumes perhaps?

The only interesting thing, Kev, in terms of these top 20 months, the ones that were in the summer were actually June, July, August. They happened all in 2006. And I think back then in 2006, you had the US housing bubble. The Fed was at the long end in terms of their tightening cycle, and people were worried about the yield curve and negative territory, and Ben Bernanke, and you were starting to hear about subprime. So that was a one-off, but to your point, Kev, they were one-off incidences that led to that volume that typically wouldn't happen. Now the bottom 20 months, Kev, in terms of volumes, 40% of them happened in the summer. So there is truth to that, that of all the months, those three months in the summer, 40% of the low volume happens there. And the reasons make sense.

Kevin Headland:

Yeah. And I think it's definitely understanding, because I don't think volumes is not just buying, right? It's buying and selling. It's actually activity. So through the summer, people are paying less attention to their portfolios, again, vacation, whatnot.

Macan Nia:

Vacation is a big one, right?

Kevin Headland:

Yeah. It's a broad base. So it's normal that volumes would be low. And I think that's why you see some of these often more volatile months can often happen in the summertime, because if volumes are low, it doesn't take much of a will, shall we say, to make the market a little more volatile, where it's a buying pressure or a selling pressure. Low volumes can add to volatility because it doesn't take much to move the needle.

But again, as we said, these are commonalities, these are not strategies we should employ. Consistency is, lack of a better term, inconsistent shall we say. You can say that. And we all know over time, compound effective money, ideally you get the money in earlier and let it last. And just a well-diversified, well-built portfolio over time will likely lead to the goals that you set for your portfolios. And trying to make these strategies based on poorly constructed, poorly planned strategies, I would say, almost becomes a pitfall or foolhardy than really anything in the end.

Macan Nia:

Yeah. I think my bigger annoyance with any of these headlines is it just adds an unnecessary, I'm not even sure what the right word is, obstacle to investing. Investing is challenging to begin with. And being inundated with these negative type of headlines that actually don't even result in anything that's actually factual just makes the likelihood of having better returns diminished. So whenever we hear these questions from audiences, in my head, I say, "Who cares?" But obviously, you have got to come in with a more eloquent answer than that. But yeah, ultimately, it doesn't matter. There's going to be other factors. Fed policy is the big one that's going to be the determinant of market returns in 2023, not the month that you decide to invest.

Kevin Headland:

And it's not even 2023. You want to obviously look even further. And one of the biggest issues, going back over history, especially today and or not today, but this day and age, is the access to information. Social media, for the average investor, they see a lot more headlines than they ever did before. And the headlines tend to be more negative. We all know if it bleeds, it leads in terms of media. And that just...

Macan Nia:

Where did you hear that? I've never heard that. If it bleeds, it leads?

Kevin Headland:

You never heard of, "If it bleeds, it leads"?

Macan Nia:

No, I haven't.

Kevin Headland:

Watch the news. It's always the bad news is what sells.

Macan Nia:

No, I get that. But I haven't heard the association with bleeding and leading.

Kevin Headland:

Oh, that's funny. Yeah.

Macan Nia:

Anyways.

Kevin Headland:

Sorry. Yeah. But it's kind of interesting there. It's that idea that that just raises more questions for the average investor. They're calling their advisor, and it's just noise in the end, right? It's just, "Okay. We've got to..." As you said, human nature, it's human bias. It's just something we're like, "Oh my God, what does that mean?" It's a shock. And we've got to really take a step back, realize that ultimately it has no impact over the longer term. And when we make a knee-jerk reaction in anything, that tends to be the wrong thing to do, especially when it comes to our investment portfolio.

And I'm going to end this off, I think it's a good way to end off, I think, and give you a last point, because I've used this for many, many years. I love this thing. I think we finally found out where the source of it was, but you have a great little sound bite for how you should be managing your money.

Macan Nia:

Yeah. Well, right now, Kev, I have Pete, who's our producer, he just messaged me saying, "Come on, Macon." So clearly, "If it bleeds, it leads" is a lot more common than what I know. But to your point, Kev, I heard this. So I've been doing this for 15 years, and I heard this very early on the road from an advisor. And he had this quote, and it was, "Investing is like soap. The more you touch it, the smaller it gets." And I thought it was just brilliant. And over the years, we've used it and no one really knew the source. And apparently, it's actually from Eugene Fama, a very acclaimed, critically acclaimed, well-recognized investor.

Kevin Headland:

Nobel laureate. He won a Nobel Prize, so yeah, well-known.

Macan Nia:

It's interesting, too. Someone else said it came from another source, so now I'm hearing it's from two sources. But regardless of who it is, I think the quote is important. That's not implying that you shouldn't touch your investments, you just buy and just never look at them. No. You have to make adjustments, whether it's on a yearly basis. But I think the idea is you're setting these asset allocation decisions. They're over long term. So yes, make changes as markets run, maybe valuations change, fundamentals change, but ultimately, you shouldn't be touching your investments that much.

And I forget where I heard this, but it makes sense to me. And this is a different thing; the institutional world in terms of the PMs, that's not applying to them. This is more for the retail audience in terms of investments, is you should be looking at your statements as much as you go to the dentist, twice a year. That makes a lot of sense to me. It means that you're ignoring a lot of the noise that happens throughout the year.

So yeah, investing is like soap. The more you touch it, the smaller it gets. And that makes a lot of sense because when I touch it, I've got to make two decisions: selling it at the right time and buying it back at the right time. And you're rarely going to want to make those decisions in that environment. Who is going to be wanting to sell when markets are running? And who wants to buy when markets are selling off? So yeah, great quote, apparently Eugene Fama.

Kevin Headland:

Well, that's great. Thanks, Macan. I think we'll end it there. So once again, for Macan Nia and myself, Kevin Headland, this has been Investments Unplugged. Thanks for listening.

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