THE OMNIVEST MARKET VIEW
Investments

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50-Day Moving Average and Sell in May

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In recent days there has been frequent commentary about the importance of the S&P 500 Index falling below its 50-day moving average. While it is true that the Index has fallen below its 50-day moving average, it is also true that since the start of 2009, the moving average has been breached 6 other times. Over this entire period, the S&P 500 Index managed to gain no less than 50.6%.

The point worth making here is that the overall trend of the market is often times much more powerful than a short-term change in a technical reading. During the 6 periods when the S&P 500 Index fell below its 50-day moving average, it stayed below this level on average of 14 days - a relatively short period of time.

Following the 50-day moving averages may prove to be a valuable tool for traders but it seems less useful of a tool for long-term investors.

The other interesting point about observing changes in market values since 2009 is that the "sell in May and go away" has only been relevant once in 2010. Clearly investors would have been well served by selling in May of 2010. However, the question to ask is whether they would have had the stamina to reinvest in July? We think not.

Certainly, any edge used by investors to make proper investment decisions is always welcomed. However, it is generally unwise to accept short-term trading strategies. Calling market tops and market bottoms can be very painful and often times wrong than right.

The current environment has been quite choppy, with the equity market confined to a relatively tight range of 1370 to 1312, or slightly less than 5% over the past month.

When the equity market is particularly vulnerable to a correction, or there is rising volatility, we often look at the performance of the corporate bond market to find corroborating evidence of rise in risk aversion. As an example, from the end of April 2011, the S&P 500 Index has lost 3% in price while the corporate bond market has gained 0.76% in price. On a spread basis, investment grade corporate bonds have widened by 3 basis points. That is hardly a move to suggest that investors are feeling uncomfortable about corporate credit quality.

In addition to the stability of the corporate bond market, we can also turn to the corporate earnings results for the first quarter. Once again, they are quite strong with 72% of the earnings being positive surprises.

Therefore, with stable credit spreads and strong corporate earnings, it seems very premature to shift to a panic mode just because the 50-day moving average has been breached. The lack of support from other indicators would suggest that market weakness should be met with incremental buying rather than panic selling. With the defensive sectors such as utilities and telecom doing quite well in recent weeks, it is time to reduce these holdings in favor of energy, materials and technology.

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