May oh my: Is it time to avoid stocks for 6 months or does recession skew investing axiom?

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CHICAGO (AP) - A time-tested strategy that calls for investors to "sell in May and go away" might sound awfully tempting this year.

Despite the market's stunning spring rally, the outlook for the economy is murky and stocks traditionally lag from the warm-weather months on into mid-autumn. Why not ditch stocks, shift into bonds and take a break from financial fretting as summer vacation nears?

Simplistic as it sounds, the approach has produced reliable results with reduced risk for decades. Since 1950, the Dow Jones industrial average has produced an average gain of 7.3 percent from November through April versus a scant 0.1 percent from May through October.

But follow the strategy at your peril, particularly in a deep recession such as this.

Switching to bonds would enable you to avoid any decline like last year's horrific 27 percent May-October plunge. But you and your battered portfolio would miss out on any continuing recovery, with the Dow still more than 42 percent below its 2007 peak.

The six-month switching strategy was first popularized by market historian Yale Hirsch in the mid-'80s. Jeffrey Hirsch, his son and co-author of the Stock Trader's Almanac, said it could still follow form this year despite unusual times. However, he doesn't advocate yanking an entire portfolio from equities.

"This is an exceptional year, and there are definitely other things at play than seasonal factors," said Hirsch, who's based in Nyack, N.Y. "The market's not going to conform to a seasonal pattern every year."

"Sell in May" is actually more an indicator than a strategy. Few investors, of course, pull out all their holdings on May 1 and put them back into stocks Nov. 1. But it may help guide investing decisions to know the implications of buying or selling at various times of year.

To illustrate how the timing can affect your holdings: $10,000 invested in the Dow during the "best" six-month period (November through April) and switched to bonds during the "worst" six months in every year since 1950 would have brought a return of $464,305. Doing the reverse would have left you, surprisingly, with a compounded loss of $1,988.

The sharp contrast in performance stems from seasonal trends and repetitive behaviors. The period between Memorial Day and Labor Day is particularly sluggish while investors are away on vacation, dragging down market returns during that time. The other half of the year, meanwhile, benefits from end-of-year bonuses, tax refunds and pension-fund contributions that all help to stimulate market activity.

Will it apply this year? A compelling argument can be made for either side.

Strengthening the case for taking the approach this year is the remarkable surge in stocks -- 25 percent in the Dow and 29 percent in the S&P 500 -- since the market hit 12-year lows in March. Sell-offs are common after such steep short-term ascents.

"Given that the spring rally was the biggest seven-week rally since 1938, the probability is high that the major U.S. market indices will not perform well during the May-to-October period," said Michael Markowski, research director of BearMarketNavigator.com, a stock-analysis Web site based in Oakland Park, Fla.

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Still, there's evidence the usual patterns may not hold in an economy like this.

The market close on Thursday confirmed not only the worst October-through-April market showing (a 12.4 percent decline in the Dow) since 1974 but also marked the first back-to-back losses during the so-called best six months since that same year.

If you peel back the layers and take a closer look, the "sell in May" indicator appears to be less effective in extreme markets. In the 13 years since 1929 that the Dow fell 15 percent or more, the performances between the two six-month periods were not significantly different, according to Paul Bolster, a finance professor at Northeastern University in Boston.

"This suggests that when market conditions get really bad, they stay bad regardless of the month of the year," he said. "2009 certainly has the potential to be a bad year for stocks from end to end."

Investors who over-emphasize the seasonal aspects of buying and selling can miss other market signals, too. **Peter Karp**, owner of Karp Capital Management in San Francisco, doesn't subscribe to the "sell in May" approach and thinks that recent weeks have brought clear evidence to the contrary.

"You need to ride this market higher," he said. "The bad news keeps being released and the market trends higher. This cannot be ignored."

Even if the six-month switching strategy has been temporarily out of whack, Hirsch of the Stock Trader's Almanac thinks it's as valid as ever.

"It doesn't work perfectly all the time," he said. "But it's worth keeping in the back of your mind."

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