Parker Carlson & Johnson

Market Comments

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May 2012

Stocks Consolidate in April

Back in March of this year after the market had recorded several months of strong gains, we wrote that stocks needed a rest before they could resume their uptrend and that's exactly what we saw in April. The S&P 500 was down slightly for the month, despite trying to resume its uptrend starting late in the month. Unfortunately the new uptrend was short-lived, as significant institutional selling moved the market back into a correction during the first week in May. So what happens now? Will May 2012 mark the third year in a row that the market rolls over into a correction?

The answers might surprise you even though the current month's influence in the stock market is well known as "sell in May and go away." Let's look at why May is often feared, what might cause it to be a problem again, and what extenuating circumstances might prevent a repeat of the last two years. First, history shows that since the end of WWII, the average gain in the S&P 500 has been more than 6% between November 1 and April 30 , but less than 1% between May 1 and October 31. Second, historical data suggests that the U.S. corporate profit cycle may be ready to embark on a cyclical downturn. Based upon the nine recessions since the early 1950's, the cyclical peak in profit for non-financial companies occurred 11 quarters after the end of the recession. When did our most recent recession end? Almost exactly 11 quarters ago, in the second quarter of 2009. Although a decline in earnings could be offset by an increase in the price to earnings multiple, history says that's not too likely as the average P/E of the S&P 500 actually fell a bit in the year after profits peaked.

Fortunately for investors, history shows that when the market has been strong over the first four months of the year, May tends to be much better than average. Since 1927, the S&P 500 Index has been up more than 10% in the January-April period 19 times. Looking at May of these years, the Index has averaged a gain of 2.19% for the month, showing positive returns over 68% of the time. During all other Mays since 1927, the Index has averaged a decline of 0.74%. So historically, the market can experience significant improvement in May when it has already seen substantial gains in January through April.

But May is only one month and there are many sectors in the market that historically perform well during this time of the year. The best sectors include food, tobacco, consumer services, banks, retailing, household products, drugs, and technology hardware, all of which we already include in our portfolio. These sectors will likely continue to perform well, given the better than expected earnings the market has experienced during the first quarter earnings season. The bottom line is there are good reasons to be wary of the market's performance going forward into the summer, but we won't let that overly influence our focus on the market's leading stocks. Perhaps the market just needs a bit more time to consolidate its recent gains. Regardless, we remain conservatively positioned heading into this period, but stand ready to take advantage of a new uptrend into the second half of the year, should one develop.

	04/30/2012	03/31/2012	12/31/2011	MTD Change	YTD Change
Dow Jones Industrials	*13213.63*	*13212.04*	*12217.56*	*0.01%*	*8.15%*
S&P 500	*1397.91*	*1408.47*	*1257.60*	*-0.75%*	*11.16%*
Nasdaq Composite	*3046.36*	*3091.57*	*2605.15*	*-1.46%*	*16.94%*
Russell 3000	*1520.48*	*1532.24*	*1364.15*	*-0.77%*	*11.46%*
2-Year Treasury Yield	*0.26%*	*0.34%*	*0.24%*	*-0.08%*	*0.02%*
10-Year Treasury Yield	*1.91%*	*2.22%*	*1.87%*	*-0.31%*	*0.04%*

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