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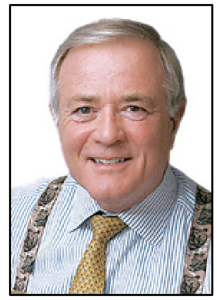

William Rutherford

Sell stocks in May and go away? No way!

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Many myths persist in the market. Some have a bit of truth, and that is enough to keep them around: "Don't fight the Fed," "Don't fight the tape," and "sell in May and go away." Do we hang on to the latter because it rhymes, or because it works?

Of course, if one has a taxable account, one has to take into account capital gains taxes. The saying has some credence because historically stocks in May advance only 52 percent of the time, but – on average – 62 percent of the time in a month. Is this a year to sell in May? It doesn't look like it.

After a strong start to the year, equities are up more than 18 percent year to date. For a time, stocks paused to let the economy catch up, but then resumed their upward trend. Earnings have been better than expected. About 70 percent of firms that have reported so far have beaten street estimates on income; only about 20 percent have failed to meet estimates.

However, revenue is another matter, as most firms have failed to meet their revenue targets and have signaled tough sledding ahead. Unemployment numbers remain persistently high, economic numbers remain weak, and gross domestic product growth is sluggish. The efforts of the Fed to jump-start the economy are having less and less impact. Sequestration has only begun to take effect.

Signs are mixed for the global economy. Europe remains troubled, but at the moment seems to be stabilizing. Headwinds persist, but the market is staying on its upward course with brief interruptions. Indeed, the surprising upward drift of the market in the face of persistent bad news may be one of its strengths. It is a rally that is widely disliked. Can the market continue its "melt up," or should we be "selling everything that is not nailed down?" One prominent money manager has stated as much.

Apple was able to complete the biggest bond offering ever at exceptionally low rates in spite of a rating less than AAA. The offering was three times oversubscribed. Apple joined the ranks of another gilt-edged company, IBM, in large debt offerings. Are these signs of a bubble in bonds, or is it a good thing for equities? After all, the offerings provide more capital for expansion and reduce the cost of debt for offering companies for a good long time.

In the case of Apple, they have effectively repatriated $15 billion in cash of the nearly $100 billion that they have earned overseas but cannot return to the U.S. because of taxes. In their case, they avoided $7 billion in U.S. taxes. This will give President Obama more ammunition for raising taxes, but because Apple plans to use the cash to pay dividends and buy back stock, the U.S. Treasury will receive back much, if not all, of the $7 billion tax savings from personal income taxes paid.

The debt offerings are a plus for the U.S. economy and the Treasury. Perhaps they will do what the Fed has been only marginally successful at doing: growing business. The total U.S. economy is growing at an anemic rate of approximately 2 percent, when we need and could be growing at 4 percent. We could be growing at a faster rate were it not for the uncertain economic policies flowing out of Washington. At a 4 percent GDP growth rate, unemployment would be much lower and tax revenues much higher.

We have several pluses in the economy. Interest rates are low. Energy prices are lower than they have been. Housing is recovering. Household debt is down, and household net worth is back to 2007 levels, fueling consumer spending. And yet economic growth is sluggish. It is not surprising that the market is higher, but it is surprising that it is doing so well in the face of the obstacles coming from the executive and legislative branches of the federal government.

What is an investor to do? As I have said often before in this column, the market climbs a wall of worry. Investors are still seeking yield, which explains how Cyprus was able to sell bonds at a time when their problems were being hailed as the end of the euro and the European Union. This scenario was reminiscent of the worries over Spain, Portugal, Italy and Greece. They each presaged disaster that did not strike. Each of these countries has seen their recent debt offerings well bid with lower interest rates.

Along with the U.S., German markets are trading at all-time highs. Japanese markets are trading at five-year highs, as central banks lower interest rates. The European Union appears poised to remain intact.

We remain the best house in a bad neighborhood, so investors are still investing in U.S. equities. With economic growth expected to remain sluggish for years to come and interest rates low, perhaps this is the only place to invest for growth. I recommend that investors consult with a financial adviser about how to participate in the current market.

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