BNY MELLON

iFlow

MACRO MORNING BRIEFING

May 2 2024

Seasonal Risk And iFlow

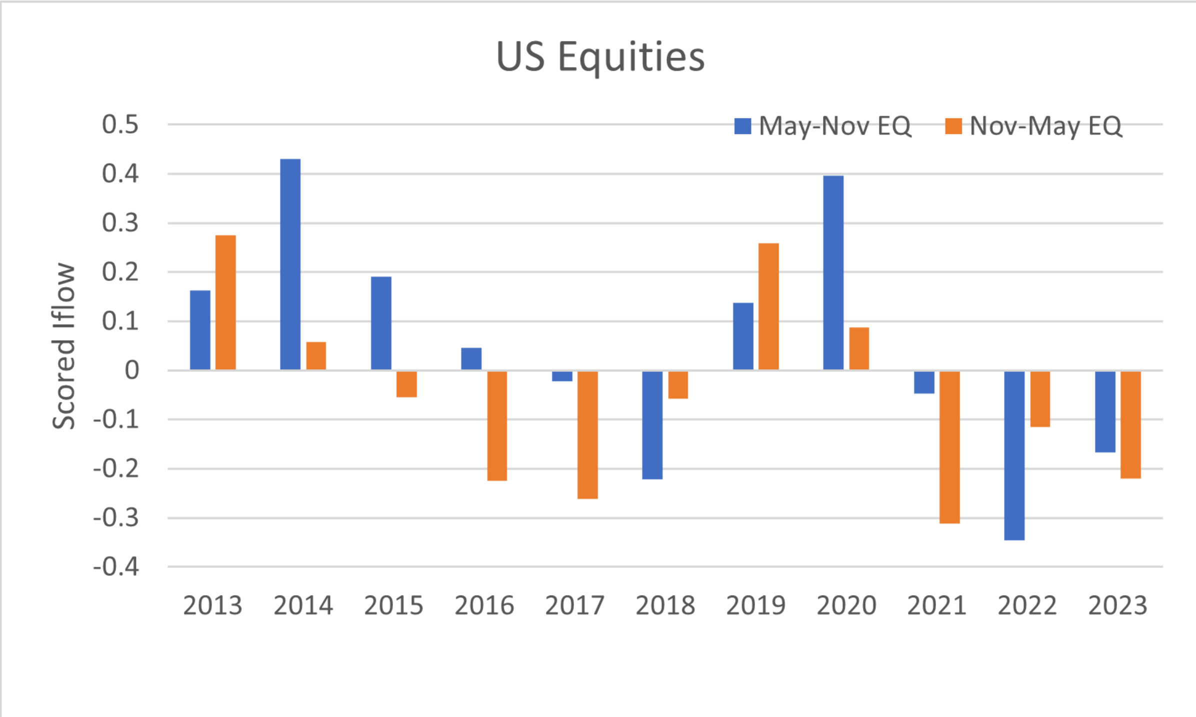
The fear factor of seasonality shows up as a trading guidepost most clearly in May. The adage "sell in May and go away" has had a good track record over the past 50 years but failed in the last ten. The problem with seasonality beyond the limited sample set starts with how other markets interact with equities. The question of whether to sell stocks only in May is worth considering, along with other correlations.

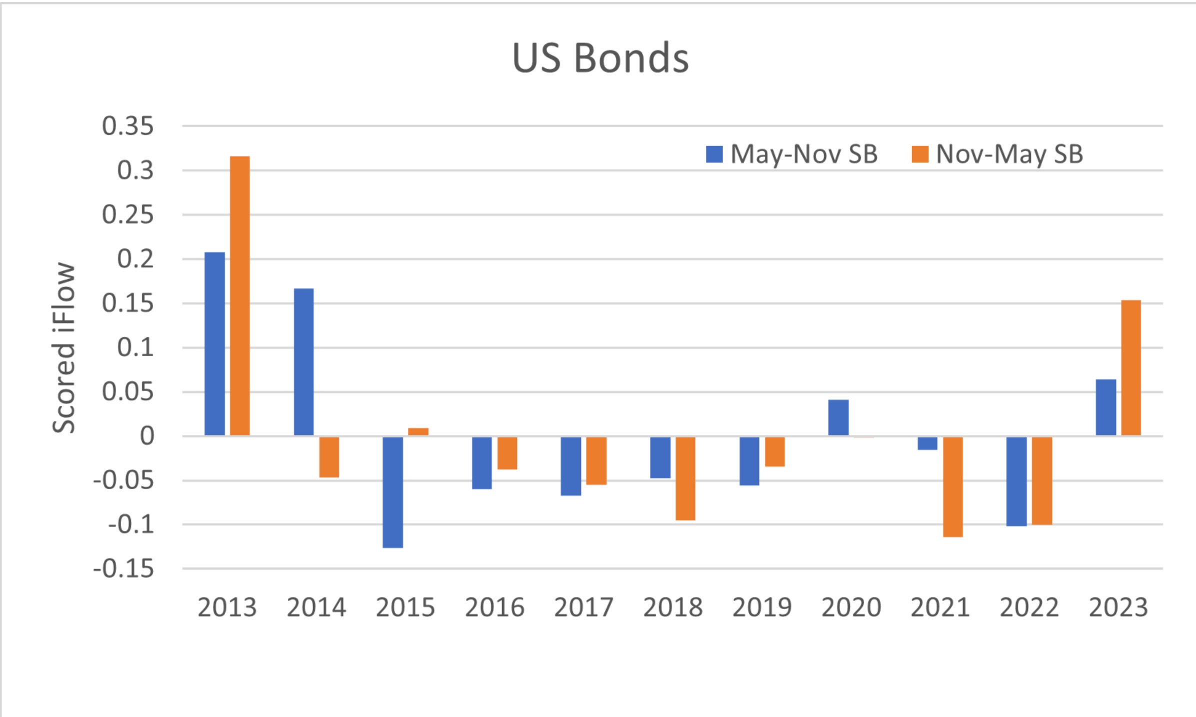
Bonds for the last decade have taken a backseat in portfolios because of their low yields during that time frame. The shift from negative to positive real rates matters to how seasonality works for stocks and for other markets. In the commodity space, for example, trading a spike in gasoline prices over the summer driving season is popular. And in FX, buying the US dollar in May has been a winner for 20 years.

- The sharp turnaround in US equities – gains of 3% last week followed by flat this week – leaves many worried about how they fare in May.
- The turn in our iFlow Mood indicator is notable as well – suggests the swing is not just about US equities but global, as well as a desire to own G10 bills.
- The outcome of the Federal Reserve's policy meeting this week, i.e., bias to hold or ease rather than hike, offered little comfort about the growth trajectory of the US (and world). 'Recovery' sectors suffered reversals globally.
- The US bond market has not functioned as a hedge for risk in this turn – the correlation of stocks to bonds is not sufficient to offset the losses.
- Our iFlow seasonality suggests the May-November period works best for bonds, rather than stocks.

The “sell in May...” adage came early for US equity markets – starting with the first four weeks of April. What does that mean for May? The last ten years are the anomaly, as we saw the hangover of zero rates and the pandemic clash with the forced shift in monetary policy at odds with fiscal. Over the last 50 years, the S&P 500 has gained an average of 4.8% between November and April, and just 1.2% between May and October, according to Reuters calculations. However, over the last 20 years, the outperformance of November-April over May-October narrows to 1%. Over ten years, November-April has underperformed May-October by one percentage point, and over the last five years it has underperformed by three percentage points. Explaining this shift in markets starts with real rates.

Exhibit #1: iFlow Seasonality

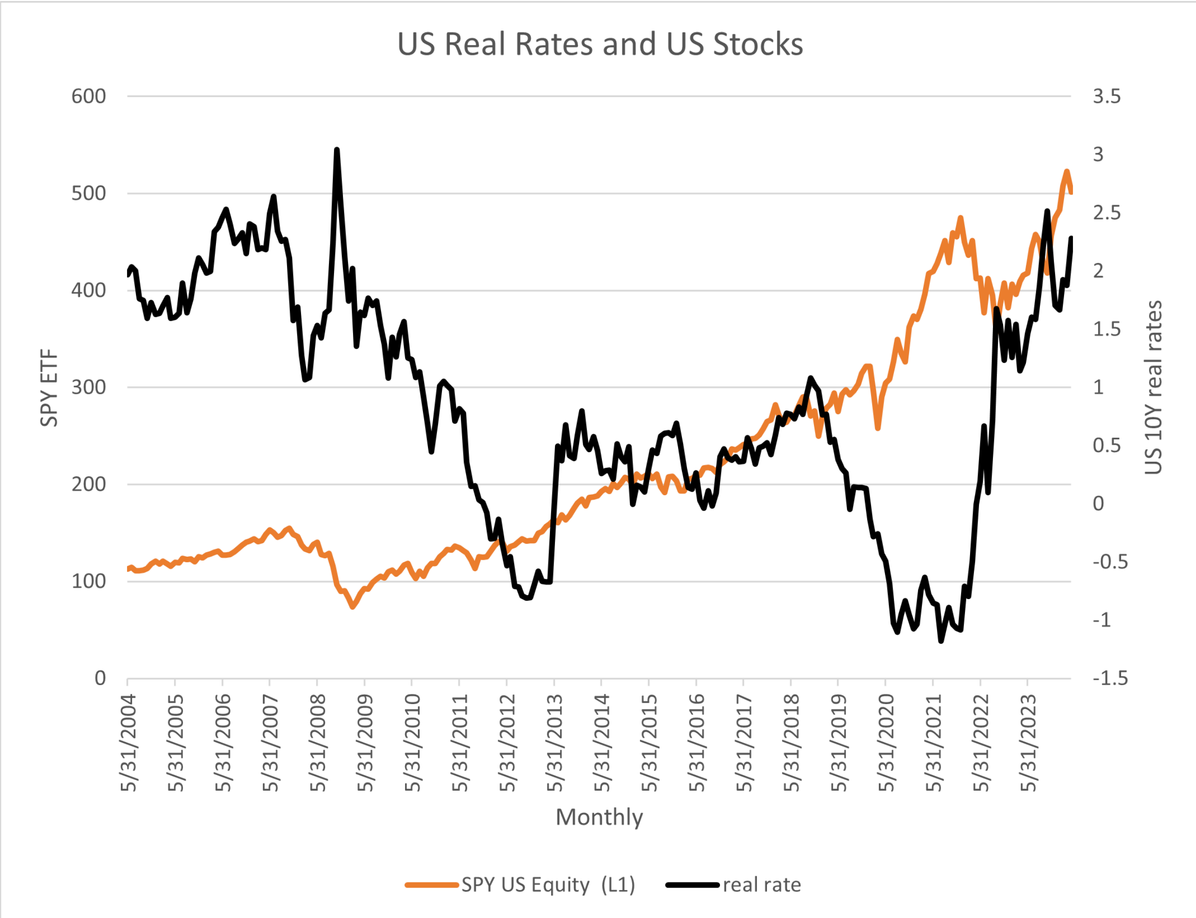




Source: BNY Mellon

Our iFlow data over the last ten years shows that US equity flows were positive in the November-May period just four times, while bond flows were up seven times. The logic of buying US bonds in May in the last ten years is counterintuitive but rhymes with the logic of selling equities. The actual performance of 10-year US bond holdings over the last 20 years from May to November is -0.1%. The S&P 500 performance over the same period is +2.4%

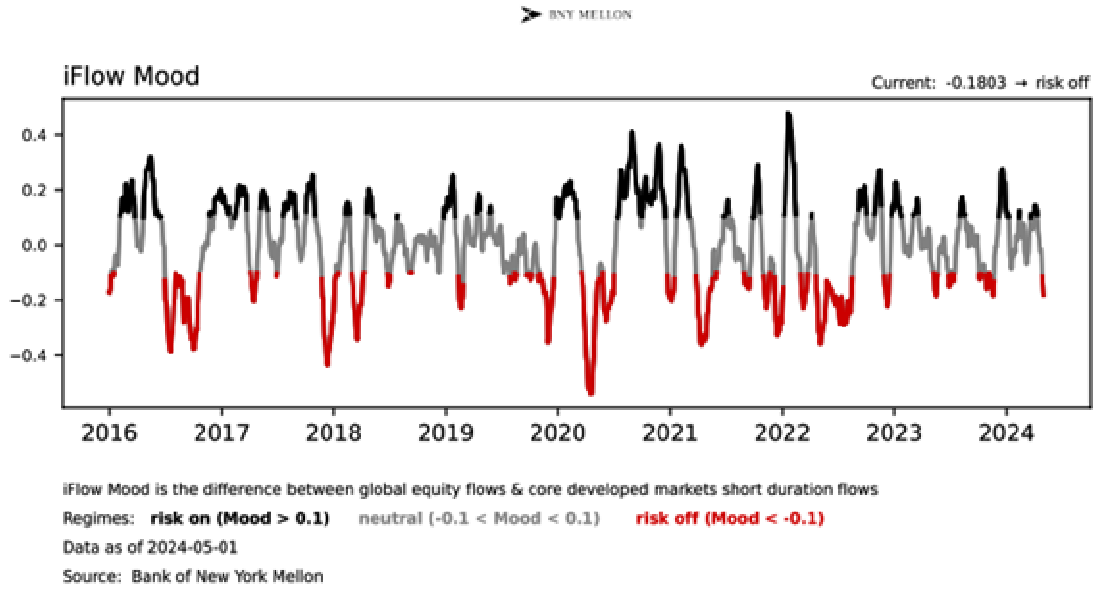
Exhibit #2: US Real Rates & US Stocks



Source: Bloomberg, BNY Mellon

Linking the present swing of 'risk off' to shifts in Fed rate-cut expectations has been a waiting game amid corporate earnings reports. iFlow data offers a few insights into the shift in Fed pricing in April. The first: 'risk off' remains the hallmark. Our iFlow Mood indicator is significantly negative now – only the second time in 2024. The average duration of this state is eight days of significant stock market volatility – we are just in day four of such – with the median risk 17 days.

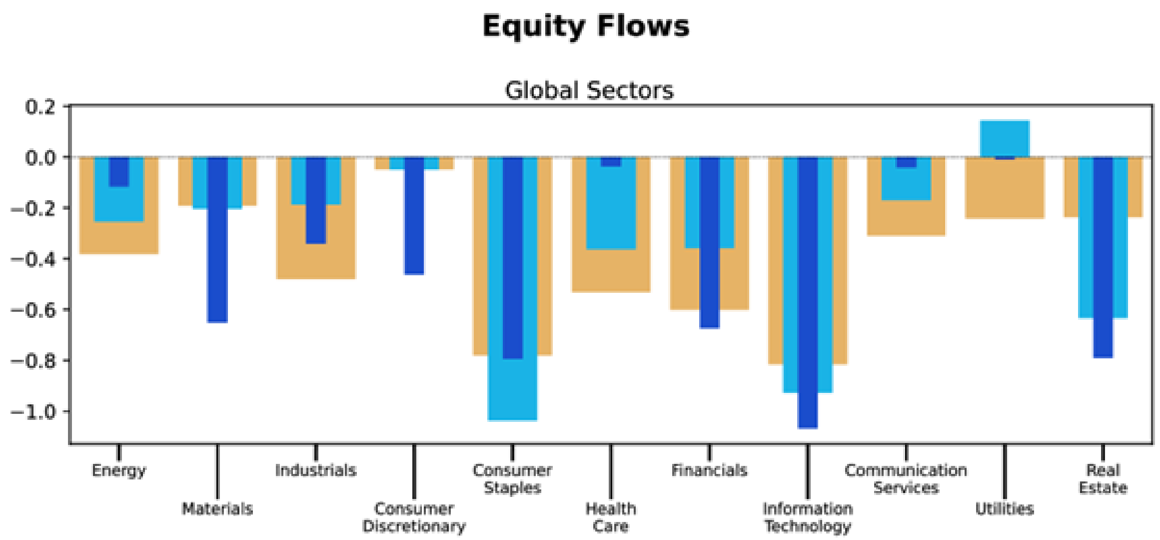
Exhibit #3: iFlow Mood Signals 'Risk Off'



Source: BNY Mellon

Exhibit #4 below shows outflows from all equity sectors globally this week (dark blue bars). Over the past month (light blue bars), only Utilities managed inflows. This is a big shift from mid-April, when APAC and most EM regions saw inflows. The global growth recovery story has shifted as US rate policy returns as a dominant concern. Even expectations for easing in Europe, e.g., in Sweden, Switzerland and by the European Central Bank, have not sufficed to support those markets.

Exhibit #4: All Equity Sectors Suffer Outflows This Week



Source: Oraculus, BNY Mellon

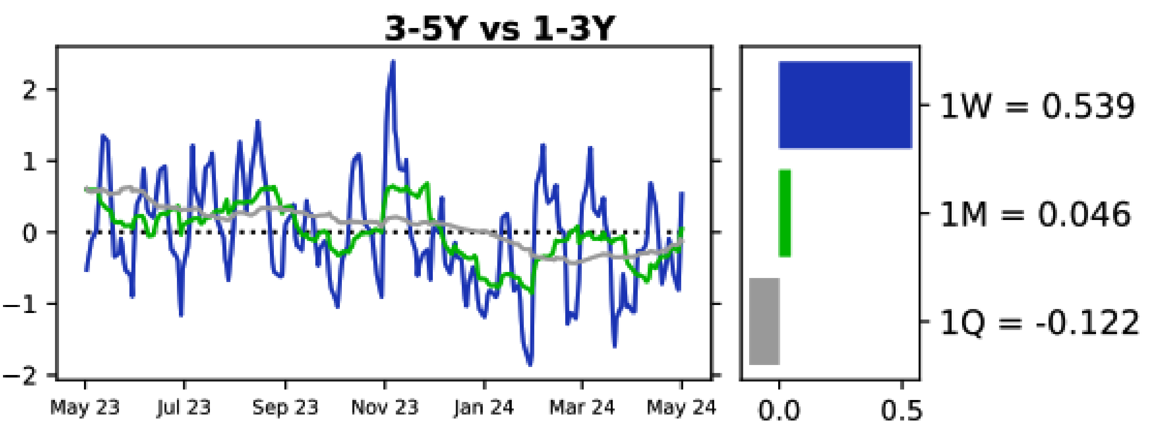
The sectors in which our flows show both leading and following returns: selling in Energy, selling in Consumer Discretionary, selling in Financials, selling in Real Estate. The only sector clients are buying is Utilities, leading returns not following.

The iFlow sector data clashes with Q1 earnings. Blended earnings in the last week (just 46% of index reporting) is 3.5%, up from 0.5%, led by Communications and Health Care. The big tech reports were mixed. Focus on net profit margins remains key: 11.5% so far in Q1, flat to last year and the five-year average. As FactSet notes, six sectors are reporting a year-over-year increase in net profit margins in Q1 2024 compared to Q1 2023, led by Information Technology (25.5% vs. 22.4%), Utilities (13.4% vs. 10.3%), and Communication Services (13.5% vs. 10.9%). By contrast, five sectors are reporting a year-over-year decrease (same comparison) in net profit margins, led by Health Care (6.3% vs. 9.3%) and Energy (9.6% vs. 12.5%).

But 'risk off' in equities globally has a link to how fixed income markets think about markets overall – we are seeing flows return to the short US 2y/long US 5y trade with equity flows negative on the month and quarter. The turn of this trade suggests a view of high-for-longer Fed policy risking a recession in 2025 – so fewer rate cuts now lead to more later. The situation in Europe appears analogous.

FX markets have a role in the unfolding narrative for May, as well. The correlation of USD strength to global sovereign bonds has returned – back towards the highs at the start of the year. The divergence trade of ECB and Bank of Canada easing before the Fed sustains as a dominant hope for the rest of the world. USD correlation to sovereign bonds now is 0.55%, in the eighty percentiles.

Exhibit #5: US Bond Flows Show Prep For High-For-Longer Pain



Source: BNY Mellon

Bottom Line: The Fed's data-dependence suggests that the next few weeks will be increasingly difficult for markets – positioning and liquidity will be hard to ignore. The "sell in May..." adage may be more linked to the USD and real rates than to any power that seasonals might have. We think the correlations that should worry investors most in the next few weeks revolve around stocks and bonds moving with surprises either to the upside in US growth and/or the downside in inflation. US April jobs data reported today will be the first test. The so-called whisper number for nonfarm payrolls is +245k. Our back-of-the-envelope estimate is much lower, +165k, given the tightness of financial conditions and less consumer confidence about jobs.

Disclaimer & Disclosures

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