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The Dead Zone

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The title "The Dead Zone" sounds like something from a Rod Serling movie doesn't it? (for those who still remember his shows) However, thanks to the work of Yale Hirsch of the Stock Trader's Almanac the Dead Zone is a description of the phenomenon that occurs between May and October of each year. Mr. Hirsch discovered that since 1950, the favorable period to be invested in the stock market has been from November through April. Surprisingly, 99.9% of all stock market gains since 1950 have occurred between these six months. On the other hand, the unfavorable time period, May through October, has resulted in nearly zero returns.

According to Alan M. Newman, in his April 26th, 2004 edition of *Crosscurrents*, an investment of $10,000 in the Dow Jones Industrial Average in 1950, during the Dead Zone, would have produced less than $431. However, the same $10,000 invested from November through April would have grown to $487,322. Hence the phrase "sell in May and go away," which has become more commonly heard in the media. So what happened if you bought and stayed in the Dow Jones Industrial Average for the entire year? Your return was roughly half what it would have been, had you been invested only between November and April. [1]

What could be causing the market to rally from November to April? Mr. Newman points out that since 1984, the months January and April account for 26.6% of all mutual fund contributions for the year, possibly due to year-end salary bonuses and IRA and pension contribution during tax season. For the favorable period of the year, mutual fund cash inflows have averaged 60.95% of total annual contributions. Since prices in an open market move up and down based on buyer's demand, the inflows of new money literally push prices higher during this time period. Add to the equation those investors who are reallocating dollars and trying to chase the latest trend and you have a pretty significant force on your hands.

Does it always work? No. If an investor had employed this strategy in 2002 – 2003, they would have made some money between November and April, but there were somewhat better gains to be made between the "unfavorable-period" of May to October of 2003. There have been other years when this strategy was unsuccessful but those years did not prevent the remarkably successful years during the 54 period from 1950 to 2004. According to Mr. Newman, the Dead Zone pattern was even more pronounced during the lengthy Bear market of 1966 to 1982. So, if we are still in a secular Bear market as some suggest, awareness of this market pattern may provide some comfort and assistance to the investor who chooses to follow it.

In the past couple of months, the market has shown more consistent market weakness than investors have seen in the past twelve months. The normal, healthy pattern of the stock market is a series of short-term advances each followed by short-term corrections. This is similar to our daily pattern of 16 hours of activity each day followed by 8 hours of rest. If people change this pattern and stay awake for 48 hours, then a longer period of deep rest is needed to return to health. In the same way, markets that do not correct their excesses on a regular basis often experience more protracted corrections. In the case of our current economic situation, most major stock indices rose for almost a year, from mid-March'03 to mid-February'04, without more than 5% correction. Therefore, a deeper more extended decline may be needed to restore buying enthusiasm. Just in time for the Dead Zone.4

[1] The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. Past performance does not guarantee future results. One may not directly invest in an index. This is not a recommendation of any securities.