E-Memo

TO: INVESTORS/MEMBERS AND FRIENDS
FROM: Jon Bruss and Bob Ollech
Date: May 8, 2005
Subject: Sell in May and Go Away? Another Myth About Banks?

Yes! Unequivocally, yes, another myth about banks.

Recently the research department at Bear, Stearns & Co., Inc. produced a report under the banner "Quantitative Strategy" entitled *That Time of Year Again—Sell in May and Go Away! (April 28. 2005).* According to Bear, there is a "great deal of statistical evidence to support this idiomatic expression." They point out in their study that "the period ranging from May through October has indeed been associated with some of the worst market episodes of the past 50 years." Furthermore, they point out that "historical evidence certainly supports the 'sell in May and go away' philosophy." Finally, they contend "the important thing to look at when studying seasonality patterns is the batting average." In other words, are the six-month returns (May-October and November-April) the result of a "common occurrence or just one or two unusual episodes"? And, most important to us and our fellow investors in Foundation Financial Partners, does that pattern hold when investing in small cap banks?

We decided to find out. We compared the performance of the S&P 500 using the "Sell in May and Go Away (SIMAGA)" strategy to the performance of the NASDAQ Bank Index. It is important to note that our data base provider, Bloomberg, does not have dividend/total return data for the Bank Index until 1995. Therefore, we compared apples to apples using total returns for both indices *without* reinvestment of dividends. We used the seven best and seven worst performances from the NASDAQ Bank Index and the S&P 500 Index. Here's what we found:

Best vs. Worst Returns
May-October and November-April
1985-2005

NASDAQ BANK INDEX
S&P 500 INDEX

RETURNS			
May through October		**November through April**	
Best	*Worst*	*Best*	*Worst*
40.05%	-31.62%	38.54%	-20.01%
22.96%	-20.91%	26.83%	-16.08%
21.50%	-17.76%	25.52%	-11.57%
20.44%	-15.74%	23.47%	-3.62%
18.26%	-12.68%	22.66%	-2.81%
16.45%	-8.10%	19.31%	-2.29%
15.68%	-6.94%	18.19%	-2.28%

Source: Bloomberg, LP and Fortress Partners

Clearly banks had the best of seven performances (6 of 7) in the May through October period while the S&P had the worst performances (4 of 7). In the November through April period, banks again had the best of seven performances (4 of 7) but then came the worst performances for the November through April period and banks had the worst of seven with (4 of 7).

The first conclusion we came to is that while it may make sense to sell in May and go away if your investments mimic the S&P 500 Index, the same cannot be said for investing in small cap banks. An investor in the S&P 500 Index would have achieved a higher annual return by selling out on the last day of April each year and putting the proceeds into six-month T-bills until October 31. As the data in the table below shows, that strategy gained the investor 70 basis points of annualized returns (10.45% vs. 9.75% if fully invested for the entire year), while also lowering risk (since the investor was out of equities for six months out of the year). Of course, this analysis ignores complicating factors such as capital gains taxes and trading costs, which would have reduced the investor's net return.

What does the data show when the Sell in May strategy is applied to small cap banks? Something quite different. We applied the same strategy to the NASDAQ Bank Index, assuming our investor owned the bank index from November through April and then sold out and invested in six-month T-bills for the remainder of each annual period. Here's what we found for the twenty year period from May of 1985 through April of 2005 comparing the annualized returns of both the NASDAQ Bank Index and the S&P 500 Index (both without reinvestment of dividends):

Annualized Returns
May 1985 through April 2005

Annualized Return (w/o dividends)	**NASDAQ Bank Index**	**S& P500 Index**
May-October (w/6mo. T-Bills Nov.-Apr.)	6.48%	4.67%
November-April (w/ 6mo. T-Bills May-Nov.)	11.18%	**10.45%**
Fully Invested in Index	**12.60%**	9.75%

Source: Bloomberg, LP and Fortress Partners

It looks to us as if investing in the S&P 500 Index from November to April and putting the proceeds in T-bills until the following November might not be a bad idea, at least over the past 20 years. However, doing that with small cap banks would have resulted in a lower return (11.18% vs. 12.60%) than had you stuck with them for the whole year, each year for the last twenty. In terms of annualized percentages, some of the differences between the periods and the indices don't look that significant. However, if you assumed a $100,000 investment in the NASDAQ Bank Index vs. the S&P 500 Index, the dollar difference tells another story. Through the magic of compounding, the results look like this:

Value of $100,000 Invested
May 1985-April 2005

Total Return (w/o dividends)	**NASDAQ Bank Index**	**S&P 500 Index**
May-October (w/6mo. T-Bills Nov.-Apr.)	$250,839	$149,176
November-April (w/ 6mo. T-Bills May-Nov.)	$732,570	**$629,826**
Fully Invested in Index	**$975,197**	$543,300

Source: Bloomberg, LP and Fortress Partners

Selling in May and going away might not be a bad idea when investing in the broader equity markets, but it sure looks like it would be a foolish strategy for investing in small cap banks! That $100,000 investment in the NASDAQ Bank Index in May of 1985 would worth $975,197 if you were actually able to invest in the bank index back then. Unfortunately, you can't invest directly in the NASDAQ Bank Index; we know of no fund that replicates it. However, there are a number of investment vehicles that use the NASDAQ Bank Index as a benchmark, including Foundation Financial Partners, LLC.

Yes, Selling in May and Going Away is an "idiomatic expression." It is also myth about investing that surely doesn't apply to banks. We've gone through the same calculations with the portfolios we manage and we'd be happy to discuss those with you should you have a further interest.

For another interesting study of the role a diversified portfolio of small cap bank stocks can play in enhancing the returns and lowering the volatility of your investment portfolio see our April *E-Memo* "Small Bank Stocks – A Natural Hedge for Your Portfolio" in the **News & Info** section of our website at www.fortresspartners.com.

FORTRESS
PARTNERS
CAPITAL MANAGEMENT, LTD.
700 Walnut Ridge Drive, Ste 200, Hartland, WI 53029
262-369-5369 (Jon Bruss) • 262-369-5742 (Bob Ollech)