

An Options Approach to Sell in May and Go Away 2023



Tom Gentile

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THE ADAGE: SELL IN MAY AND GO AWAY



When you hear the saying “Sell in May and Go Away”, PLEASE don’t take that as an instruction to liquidate your account. PLEASE do not think that means the markets are going into a bear market or a bearish phase.

The observation for a long time was/is the markets underperformed during the summer months in both gains and volume of investing and trading. Given that underperformance, there are those that consider selling off some of their holdings over this period of time.

That is not what this report is saying to do.

Sell in May and Go Away refers to the dates of May 1 to October 30 of a given year.

This is a 6-month period of time where the returns of the market are less robust than the other 6 months (October 31 through April 30).

2 SEASONS OF TRADING: SUMMER AND WINTER

The sell in May and go away months are deemed the *summer months* and somewhere along the line you either heard of or will eventually hear the term for this period of time called the 'summer-doldrums'.

These are considered the 'summer' months whereas the months from November (October 31) to the end of April are considered the *winter months* or the Halloween Pattern.

Whether you are new to investing and what we do, new to options trading, or you are a seasoned veteran of either or both, you will or may have already heard the saying 'Sell in May and Go Away'.

Where the saying has what may seem like a bearish tone to it, that is not necessarily the case I want to educate you on. We are not saying to do what others have done in the past, which is sell or reduce holdings in one's portfolio on the last day of May and do nothing for the next 6 months.

This quick special report is a means to address what Sell in May and Go Away means to me and my team and our approach to trading options during this period of time in the markets.

PERFORMANCE COMPARISON



The most powerful tool one has as an investor is Time. The longer one stays invested, the more the power compounding interest has to work and grow one's money.

As an options trader, the challenge is the underlying securities may not make as much of a price move at other times of the year, and a less robust price move may not give as much ROI potential in the option. But there are options strategies that can take advantage of time decay and not need as strong a price move to reap profits. Strategies like Credit Spread and or Time/Calendar Spreads.

Before we go into the options strategies and case studies as examples of option trades for this period of time let's go over the data of how the markets perform over the Sell in May months.

The researched data shared is from various sources and we will reference where the data came from. According to Fidelity Investments in recent years, the S&P 500 Index gained an average of about 2% from May to October since 1990. This compared with an average of about 7% from November to April.

BE ADAPTABLE

There may be incidents going on during a period of time that speak to being adaptable as an investor/trader and not be stuck with the mindset that the pattern is going to absolutely play out. One must be amenable to adjusting their strategy for their portfolio.

In our Sell in May report from a couple of years back, when the pandemic/COVID was front and center for the world, to be concerned with Selling in May wouldn't have done anyone following that adage any good.

In 2020 the S&P 500 dropped 34% over five weeks in February and March due to COVID-19. It then gained 12.4% from May to October.

A write-up from www.investopedia.com shows data from LPL Research the SP500 averaged a return of 3.8%, with no significant decline since 2011.

Here is a table from www.invetopedia.com showing the Returns of the SP500 over this 6-month period since 2011.

S&P 500 "Sell in May" Returns (May-October)

Year	S&P 500 "Sell in May" Return
2011	-8.1%
2012	+1.0%
2013	+10.0%
2014	+7.1%
2015	-0.3%
2016	+2.9%
2017	+8.0%
2018	+2.4%
2019	+3.1%
2020	+12.3%

Source: LPL Research

Here are a couple of pieces of historical information from www.balancemoney.com:

- Since 1945, the SP500 realized an average 2% return May through October.
- The other 6 months it saw an average gain of 6%.

Since 1990, these return figures have basically stayed the same, performing at 3% and 7%, respectively.

Another piece of historical information is that between 2010 and 2020, 2011 is the only year that the SP500 underperformed.

In every other year of that decade, one could have outperformed the market between 0.8% and 13.9% if they stayed invested from May through October.

FACTORS THAT MAY HELP THE MARKETS DESPITE HISTORICAL SUMMER DOLDRUMS

Data from Merrill Lynch analysts say that May saw a stock market advance 57% of the time. Going back to 1928, the 3-month June-August period typically is the second-best of the year, realizing a gain 63% of the time. Of which the average gain is 2.9%.

Merrill goes on to write that a weak May normally results in a "more robust" June-August period.

Sam Stovall, Equity Strategist for S&P Global Market Intelligence noted last year, the S&P 500 Index (SPX) gained an average of 1.4% in the "summer" months since 1945, which he also noted would have been better than going to cash.

Here is something else to consider this year.

3RD YEAR OF A PRESIDENTIAL TERM

We are in year three of President Biden's first term in office. Historically the third year of a Presidential cycle is a bullish one for the markets. Here is a table from Schaeffer's Research showing the average return in a President's third year.

S&P 500 Since 1949				
Presidential Cycle Year	1st	2nd	3rd	4th
No. of Returns	19	19	18	18
Average Return	8.04%	4.62%	16.78%	7.28%
Median Return	9.06%	1.06%	18.08%	10.75%
Percent Positive	63.2%	52.6%	88.9%	83.3%
Average Positive	19.72%	19.97%	18.92%	12.18%
Average Negative	-11.99%	-12.43%	-0.36%	-17.20%
Std. Deviation	17.57%	20.23%	11.03%	14.34%

Provided by Schaeffer's Research

5 STYLES OF OPTIONS TRADING



The previous data written in this report speaks to my teams and my assessment that even if there is merit to the Sell in May approach pattern, in recent years we no longer view this as a call to action to bail on one's investments and go to cash.

Though the markets (SP500) may not be as robust in the summer months vs winter months there is still the opportunity to make money whether it be with one's investments or as an options trader.

I, as an options trader, trade options over 5 ways or styles.

- 1) Seasonal - which Sell in May is a seasonal approach.
- 2) Statistical Based
- 3) Volatility Based
- 4) Momentum Based
- 5) Trend Based

In some ways, a couple of these may be similar to others on the list, say Seasonal and Statistical.

Seasonal is where a security has a pattern or history of trading up during certain parts of the year, like semiconductors tend to perform weaker in the summer, and there are statistics that say how often the security trades in a particular way or direction during certain parts of the year or over specific time frames.

'Sell in May and Go Away' is deemed a seasonal pattern in that investor decisions are made by some based on the past history of underperformance of the markets over this 6-month period.

We are advocates of trading options over the entire year.

Based on how a security or a sector of stocks trades over a period of time and how fast they move and how long it takes for them to move, dictates the type of options strategy we use on them.

The pure directional basic options strategy is going Long Calls or Puts. If one wants to hedge the cost of a pure long call or put, one can consider a debit spread (Call or Put).

If one believes they have an idea of where a security is not going to go price-wise, they can consider credit spreads (Call or Put).

If one believes a security is going to trade within a consolidated range by the options they choose expiration, they can consider a Time/Calendar Spread.

‘SELL IN MAY’? NOT AS WE SEE IT!

I realize for some they consider it best for them to simply go with the long-term investment goal; the buy-and-hold strategy. That strategy means they only want to hang onto equities year-round, year after year unless there is a change in the security's fundamentals.

Being more active than they currently are with their investments, just may not be in the cards for them.

They may feel intimidated as to what to do on their own and trusting their advisor may be deemed the safest thing for them to do. They may see it as that approach is at least better than doing nothing at all.

I agree, putting some of your money to work in the markets over the long haul versus not, is better than nothing.

But, if you are one that likes the idea of being a bit more proactive AND you like the idea of using options as a leveraged way to participate in the markets over the cost of investing in equities outright, I have a strategy for you to consider using.

Especially over this 6-month period of time.

MY OPTIONS TRADING MANTRA

- 1) Spot an Opportunity
- 2) Build an acceptable risk option trade, and
- 3) Manage that trade

Below are the two scenarios that fit the first two parts of my mantra. The third part is on you.

2 OPTION STRATEGIES (FOR EDUCATIONAL PURPOSES ONLY)



As a reminder, I am an options trader and educator of how to trade options. I do not offer recommendations and these two option scenarios are not to be taken as such.

I can show you how I use my online option data/analysis tools to find trade setups, but it is up to you to discuss the suitability of any trades in your account with your broker/financial professional.

LONG CALL LEAPS OPTION (IF BULLISH)

A LEAP option, LEAP being an acronym for Long-Term Equity Anticipation (AP standing for the word anticipation) will sometimes be called a LEAPs option, the small 's' standing for security or securities.

It is technically an option that expires out up to 1-yr or more. The January of the following year is referred to as a LEAP at times.

Recognize I am not a Registered Financial Advisor, (RIA), so I cannot, will not, and do not offer this scenario as a recommendation.

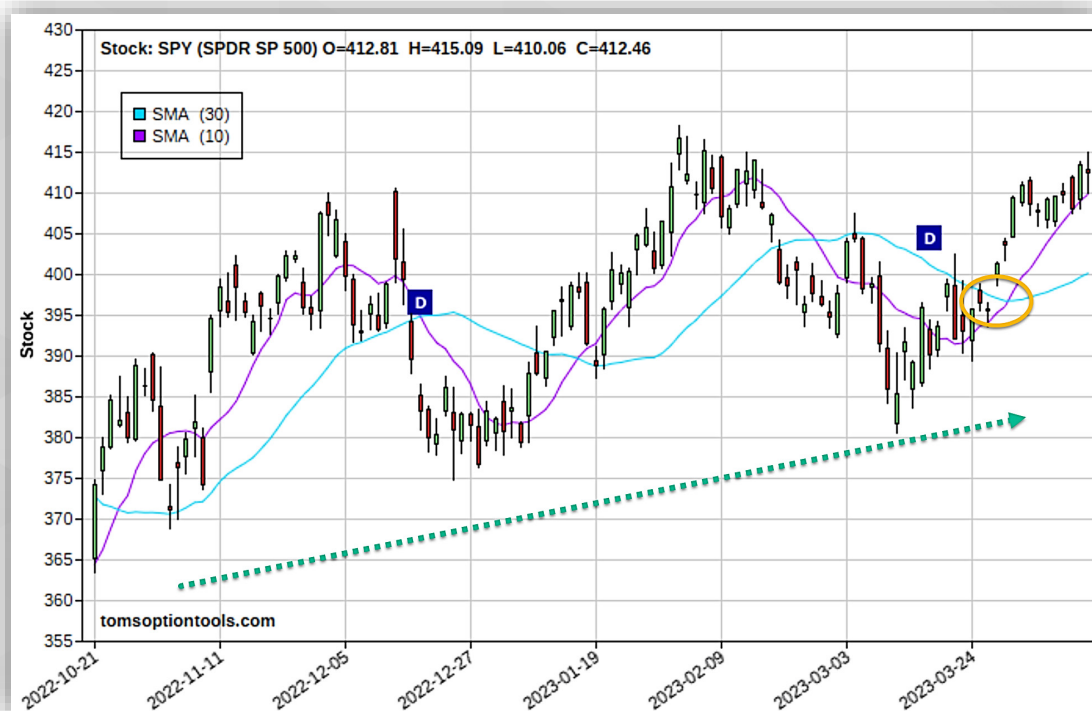


Figure 1: 120-Day Candle Chart SP500 with 10-30-Day Simple Moving Average

Leg Date	Position	Num	Option Symbol	Expire	Type	Entry
2023-04-14	Bought	1	SPY240119C410	2024 Jan 19	410 Call	34.28

I am showing the In-the -Money (ITM) option. ITM is defined as the strike price that is a lower price than the price of the security. An ITM option is one that is comprised of both Intrinsic (Real Value) and Extrinsic or Time Value.

The option being highlighted is the SPY January 19, 2024, \$410 Call option.

A Risk Graph shows the theoretical option value/profit or loss with the security at a specific price at different time intervals.

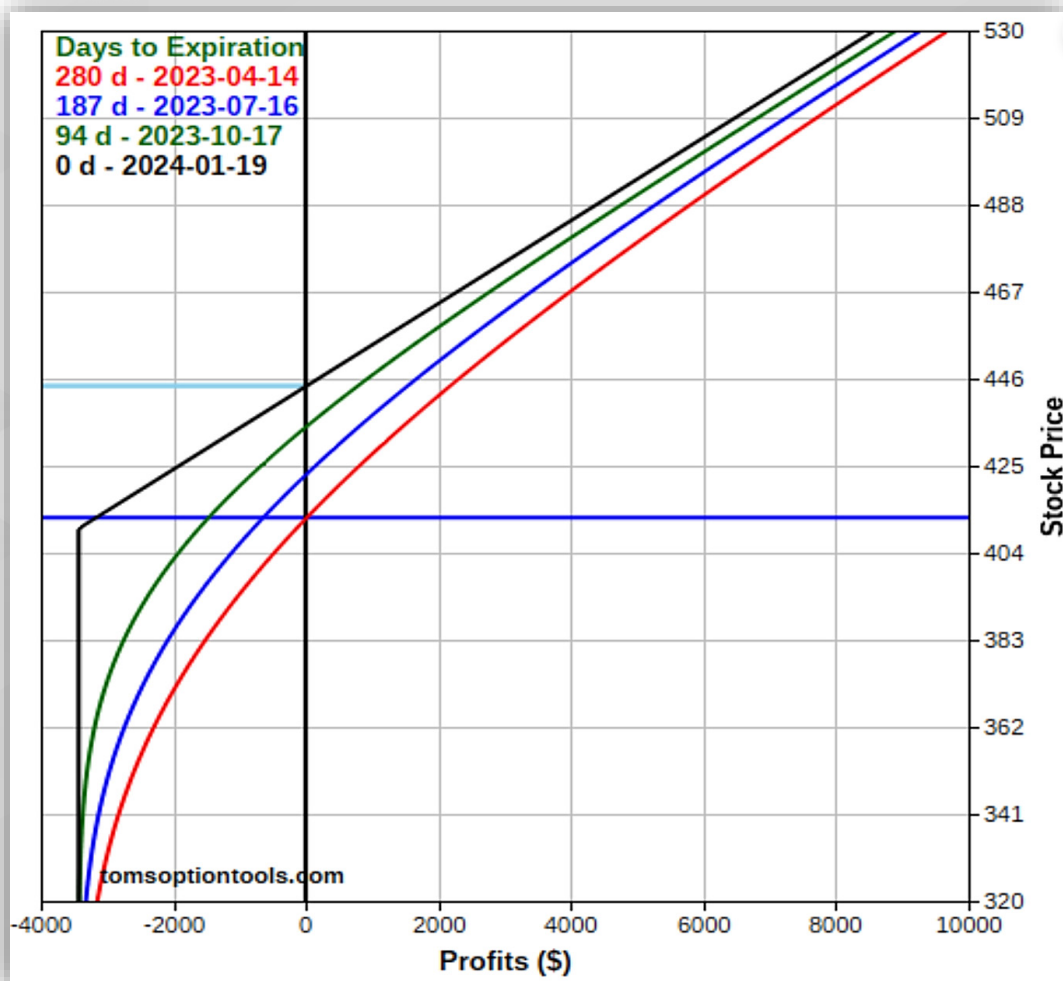


Figure 2: Risk Graph for the SPY Jan. 19, 2024, \$410 Call

In order to double the value of this option the security needs to be at a value of \$68.56.

On Real Value alone that would mean SPY needs to be trading at \$481.02.

That would require SPY to be trading back at its all-time highs.

If SPY gets closer to that price with time remaining before expiration the time value plus Real or Intrinsic Value combined may lead to it reaching that price/value without it necessarily needing to be at those all-time highs.

That still requires a lot from SPY to reach that double. Is there an option trade that can reach a double without the security having to work so hard?

LONG CALL DEBIT SPREAD / AKA BULL CALL SPREAD

A Call Debit Spread is an option trade where one would open two call options on the same order ticket. One would first assess the call option to consider 'selling to open'. What I do is look at an option with a strike price just under the target price for the security.

Once that is established, one would choose a call option with a strike price just under that sold strike (or an option somewhere under the sold strike) that would yield a ROI that one deems is acceptable. Remember if one sold to open one strike they would then 'buy to open' the other, lower-priced strike, (again, on the same order ticket).

The goal is to achieve max profitability. Max profitability on a Call Debit Spread is the difference in the width of the strikes, offset by the debit to open the trade multiplied by the number of contracts.

One wants the security to be above the sold strike price of the spread at expiration. This would cause **Assignment and Exercise**.

This means one has to search the option chain to see if there is a Call Debit Spread that could double where the price is less than the all-time highs.

Here is what we found, and this is the example (NOT trade recommendation) found.

Leg Date	Position	Num	Option Symbol	Expire	Type	Entry
2023-04-14	Sold	1	SPY230519C420	2023 May 19	420 Call	4.95
2023-04-14	Bought	1	SPY230519C415	2023 May 19	415 Call	7.45

If, in this example above, SPY is above the strike sold; the May 19, 2022, \$420 call the markets would assign the account to deliver the stock at \$420.

One would then have the right to exercise their right to buy SPY at \$415 (to deliver it at \$420). Check with your broker how that works out at their firm as both should happen at the same time. This process is called Assignment and Exercise.

One would bring in the \$5 (sell SPY at \$420 when they bought for \$415). No stock transaction costs or commissions should happen as this should be done on the strikes, not the actual number of shares.

This \$5 would be offset by the cost up front to open the trade of \$2.50 leaving \$2.50 per contract profit – or in this case – 100% ROI.

We are talking about an option that expires in less time than the 6-month period of time this seasonal pattern constitutes. As we see it, this is just fine.

Let's say the markets aren't very robust, at least not robust enough to reach previous all-time highs.

It just needs to move up 18% by the May 19 expiration, trading above \$420, and be there at May 19 expiration for max profitability to be possible.

Stock: SPY Stock News Name: SPDR SP 500 Sector: Investment Offices Dividend: 1.7 % (2023-03-17) 100 Day SV: 17.01% Trade: SPY 23May19 410-420 Call		Quote Type Entry Debit Profit Rate of Return Max Profit Max Risk Delta (Shares) Gamma Vega Theta Natural \$250.00 \$7.00 2.8% \$250.00 \$-250.00 10.44 -0.040 \$2.31 \$-1.56 Mid Quote \$250.00 \$10.00 4.0% \$250.00 \$-250.00 10.47 -0.048 \$2.32 \$-1.61 Optimistic \$250.00 \$12.00 4.8% \$250.00 \$-250.00 10.49 -0.052 \$2.33 \$-1.64
		Downside Breakeven Upside Breakeven Max Profit/Max Risk Max Profit/Cost 417.50 417.50 100.00% 100.00%

My options analysis tools works the mid-price of the bid/ask spread in the cost or premium of the options. What it shows is the opportunity to open this trade; this debit trade, at a cost of \$2.50 or \$250 for one contract.

If the most one could make is the difference of the strikes or \$5.00 for one contract or \$500 ($\$420 - \$415 = \5). The difference from the \$500 from the cost of \$250 = \$250 or a 100% ROI.

Recap: SPY needs to be trading at a price level only 18% higher than its recent closing price in order to have a chance of doubling.

The encouraging thing at the May 19 expiration is one can look at the next month or however long out they think SPY would need to make another price move higher, to position a new spread with strikes that bought and sold to open on the one order ticket have a chance of doubling again.

DISCUSS WITH YOUR FINANCIAL PRO / BROKER ON WHAT YOU WANT TO DO

This is always true no matter what time of the year you decide to put your money to work.

The encouraging thing about the Sell in May and Go Away pattern is that it is a 6-month pattern ending October 31.

In the first option scenario (bullish, less active approach) I showed a Call LEAPs option. I showed the Jan. 2022 expiration for a couple of reasons, 1) markets tend to climb a bit slower pace than when they drop, and the extra few months may be needed and 2) the option would have a chance to get those first few months of the favorable 6-months to possibly work for it.

For the second option scenario (bullish, a bit more active approach), I showed a Time Spread / Calendar Spread.

I feel these scenarios are at least worth paper trading or tracking to see how they fare in this less volatile time period.

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