LCM
LEE CAPITAL MANAGEMENT

Lee Adaptive Strategies Update

Monthly Commentary

May 2018

Sell in June?

To the optimist, May was an encouraging month in the capital markets. Volatility was generally down and the S&P 500 index was up nicely, gaining 2.41%[1]. To the glass half empty crowd, May was no less bleak than the months that came before, still too volatile for comfort, and non-US markets were down, albeit modestly.

If you have been investing long enough, you have heard the aphorism "Sell in May, and go away." It is the sort of alleged street smarts that investors repeat to each other to feel and sound thoughtful and experienced. We are not sure that anybody has ever actually acted on it, going to cash in May just because it was May. And we have never heard anything that approaches a rational explanation of why selling in May might be a winning strategy. But it does rhyme.

So it might be surprising to hear that the basic premise of the phrase turns out to be more true than not. Assuming you are willing to accept that "Sell in May, and go away" is obviously equivalent to "Sell at the close April 30 and buy at the close October 31" then there exist several academic papers published in prestigious journals that demonstrate that the six months starting with May are, on average, much worse for markets than the six months that came before. You can Google it.

6 Months Starting	Average Return
May	3.11%
Apr	3.29%
Jun	4.07%
Jan	4.87%
Mar	4.87%
Aug	5.22%
Jul	5.59%
Feb	5.60%
Dec	6.33%
Sep	6.34%
Nov	7.30%
Oct	7.61%
Average	5.35%

Of course, we are the kind of people that like to run the numbers for ourselves. Over the 25 years ending April 30, 2018, we get an average May-October return for the S&P of 3.11%, which is, indeed, the worst of the twelve possible half-year segments. See table at left.

It is worth noting that there is nothing wrong with May itself. The 25 Mays in our sample averaged an S&P gain of 0.81%, very close to the overall monthly average over 25 years of 0.85%. See table at right.

So is cashing out at the start of May and staying out until the end of October a good idea? Not especially, no. The 3.11% May-Oct average is lower than the other six-month slices, but it is still meaningfully positive. Put another way, an investor who put $1,000 in the S&P on April 30, 1993 and did nothing for 25 years would have ended up with about $9,878. Had he cleverly gone to cash every year May to October, he would have finished with about $5,331.

	Average Monthly Returns
Aug	-0.46%
Jun	-0.08%
Sep	-0.03%
Feb	0.13%
Jan	0.37%
Jul	0.78%
May	0.81%
Dec	1.45%
Mar	1.48%
Nov	1.77%
Oct	1.95%
Apr	1.98%
Average	0.85%

On the other hand, although all the six-month periods on the table at left are positive, suggesting that none of them are particularly worth avoiding, you might have noticed that three of the monthly returns at right are negative. In particular, August seems meaningfully on the wrong side of zero. Perhaps just going to cash for that one month is a sound plan?

We would be cautious about that. Over the sample period, August was an up month in 16 of 25 years. It owes its negative average return to a single cataclysmic year, 1998, in which the S&P lost 14.46% for the month. The other 24 Augusts averaged a 0.12% gain. If you thought that August was particularly accident-prone, that every decade

[1] *Source: FactSet Research Systems Inc.*

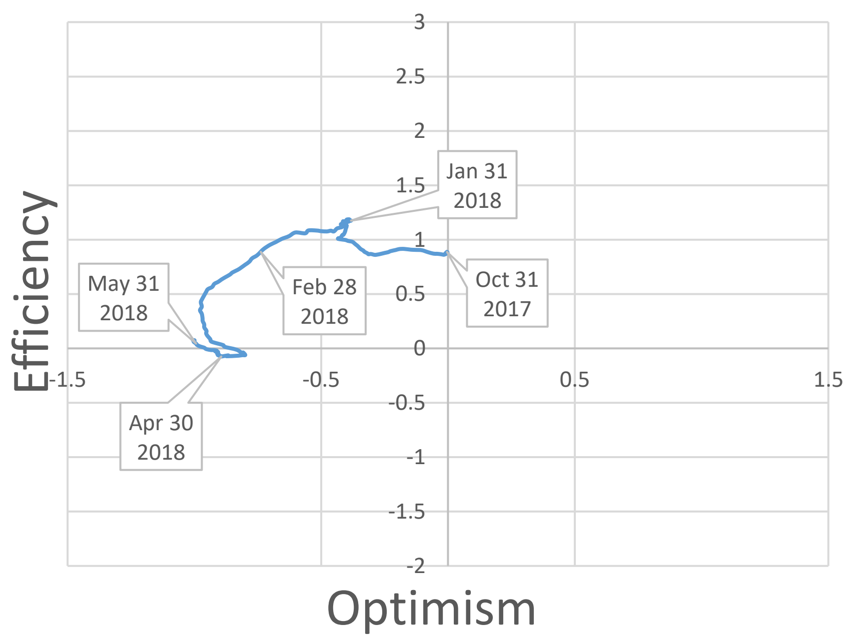
or two, while everybody was on vacation, something like the Russian Debt Crisis (1998's proximate cause) was likely to happen, then maybe cashing out for the month could make sense. We are skeptical.

To our thinking, these "calendar effect" strategies are generally unwise for two reasons. First, they are typically just observations of historical averages rather than theories about behavior that can be expected to repeat in the future. Without a strong explanation of why August is a bad month to invest, it is hard to dismiss the idea that the low average monthly return is merely bad luck. Second, even with a good reason to suspect a particular time of the year, investing based on the calendar tends to be indirect. If, for example, you believed that August tended to be a bad month because all those vacationing investment professionals cause a drop in liquidity, then would it not make more sense to use a measure of liquidity in your process rather than the calendar?

Aside from August, the other two (barely) negative months are June and September. Combined with August they do form a bit of a seasonal cluster, a suspect four month period starting May 31. Yes, due to the inclusion of July the four months do average a slightly positive return, at 0.33%. But that is quite a bit worse than the notorious six months starting in May. So why not a popular bit of investing wisdom about sidestepping these four months? As we see it, the main obstacle is rhyming "June." Sell in June, but come back soon?

The Market Sentiment Framework

We use our Market Sentiment Framework to adapt the mechanics and weightings of our full quantitative models to changing market conditions. The Sentiment Framework gauges the current state of market psychology on two dimensions. Efficiency measures the crowdedness of the market, the volume of participants seeking investment opportunities. Lower levels of efficiency imply more market mispricing. Optimism measures the willingness of investors to take on risk in exchange for distant and uncertain rewards. Higher levels of optimism imply a better outlook for risky asset classes.



Optimism fell slightly in May, from -0.89 to -1.00, a fairly trivial worsening. Although not an extreme reading, it was -2.00 as recently as Q1 2016, both the absolute level and the multi-month trend are clearly negative.

Efficiency was also nearly unchanged, rising from -0.07 to +0.07. Having crossed over into negative territory in mid-April for the first time since September 2012, Efficiency remains at a relatively low level when compared to recent history. This suggests a market that is coming under continuing stress and that is becoming less crowded. And it comports well with anecdotal evidence of a narrowing market that concentrates attention on a short list of very large technology stocks.

Lower Efficiency is good news for value investors who are now more likely to find bargains produced by a less well-functioning marketplace. But it is bad news for momentum investors who now have a smaller crowd to get in front of. Moreover, it raises the specter that in a crisis there would be fewer calmer heads ready to provide liquidity.

The current positioning of the Sentiment Framework implies a market that tends to the inefficient, with moderate opportunities for relative gains from stock picking. Optimism, although not exceptionally low in absolute terms, has been showing a downward trend and is at a level that would suggest muted, if not negative, market returns.

[1] *Source: FactSet Research Systems Inc.*

Performance and positioning

Lee Adaptive Large Cap Sector ("LALCS")

For the month of May 2018, the LALCS composite, on a net of fee basis, was up an estimated +1.85%, trailing the S&P 500, which was up +2.41%[1] on a total return basis. Year to date through May 31, LALCS is up an estimated +0.48%, trailing the S&P 500, which is up 2.02%[1].

The strategy was invested in nine of the ten sectors for the entire month of May, missing only Energy. That sector, as measured by the State Street SPDR Energy ETF (XLE) was up 2.99% for the month, modestly outperforming the S&P.

Lee Adaptive Global Equity ("LAGE")

For the month of May 2018, the LAGE composite, on a net of fee basis, was down an estimated -1.05%, behind the MSCI All Country World Index, which was up +0.21%[1] on a total return basis. For the year to date through May, LAGE is down -0.99%, behind the MSCI AC World Index, which is up +0.37%[1] over the same period.

During May, the strategy further reduced exposure to US equity and increased exposure to the other regions. It ended the month 29% US, 28% Europe, and approximately 14% in each of Japan, Asia ex-Japan, and Emerging Markets.

Lee Adaptive Global Allocation ("LAGA")

For the month of May 2018, the LAGA composite, on a net of fee basis, was down an estimated -0.64%, behind our blended benchmark, which was up +0.41%[1] on a total return basis. For the year to date through May, it is down an estimated -0.82%, as compared to the blended benchmark which was down -0.30%[1] over the same period.

The strategy began May with a 2% allocation to fixed income and ended it with a 0% allocation. With reductions in the US equity exposure, and to a lesser extent that of Asia ex-Japan, cash increased to a defensive 41%, up from 31% at the start of the month.

With 41% in cash and 0% in fixed income, the portfolio has, relative to the normal situation "baseline" portfolio, essentially swapped fixed income for cash while holding the gross equity exposure steady.

Looking more closely, exposure to the US equity market has also been reduced, to approximately 60% of its baseline weight, while the international equity regions have been increased above baseline.

We feel that this allocation is an appropriately cautious positioning in what is still an unsettled market and reflects the potential risks and opportunities in each region and asset class.

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The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. You cannot invest directly in an index.

For additional information, please read the important definitions and disclaimers on the following pages.

[1] *Source: FactSet Research Systems Inc.*

DEFINITIONS and DISCLAIMERS

Definitions:

Lee Adaptive Large Cap Sector Composite ("LALCS Composite"). A capital weighted performance composite of an investment strategy known as the Lee Adaptive Large Cap Sector strategy (the "LALCS Strategy") that holds some combination of the U.S. large cap sector ETFs and/or cash, as determined by a proprietary quantitative model. The LALCS Strategy is currently offered by LCM to (A.) certain qualified investors through (i) a single account which is a component of the overall strategy offered through a managed account Lee Diversified Opportunities Fund LP ("LDOF"), during the period commencing on December 18, 2015 through July 1, 2016 and (ii) the private fund Lee Adaptive Strategies LP ("LAS"), during the period commencing on June 1, 2016 through November 30, 2017 and (B.) certain accounts managed by LCM on a discretionary basis ("LALCS Managed Accounts"). LAS, LDOMF and the LALCS Managed Accounts all use the same investment program as the LALCS Strategy. The LALCS Composite performance is based on actual trading profits/losses/expenses net of a management fee of 0.55%. Actual expenses of operating the LALCS Strategy may vary, depending on the investment structure in which the Strategy is used, which could result in lower returns than those stated for the LALCS Composite. Such expenses may detract materially from the performance of the LALCS Strategy and, consequently, the results shown above may not be fully indicative of the actual performance results of the LALCS Strategy.

The LALCS Composite is being shown for illustration purposes only and should not be relied upon. No representations or assurance is made that any investor will or is likely to achieve results comparable to those shown above or will make any profit or will be able to avoid incurring substantial losses.
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Lee Adaptive Global Equity Composite ("LAGE Composite") Performance. A capital weighted performance composite of the of an investment strategy known as the Lee Adaptive Global Equity strategy (the "LAGE Strategy"). The LAGE Strategy is currently offered by LCM to certain qualified investors through certain accounts managed by LCM on a discretionary basis ("LAGE Managed Accounts"). The LAGE Managed Accounts use the same investment program as the LAGE Strategy. The LAGE Composite performance is based on actual trading profits/losses/expenses net of a management fee of 0.50%. Actual expenses of operating the LAGE Strategy may vary, depending on the investment structure in which the LAGE Strategy is used, which could result in lower returns than those stated for the LAGE Composite. Such expenses may detract materially from the performance of the LAGE Strategy and, consequently, the results shown above may not be fully indicative of the actual performance results of the LAGE Strategy.

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S&P 500 Total Returns Index. The returns for the S&P 500 index on a total return basis, that is, with dividends included and does not reflect the deduction of fees and expenses. You cannot invest directly in this index. The returns for the S&P 500 Index are provided for comparison purposes only to show how the LALCS Composite compares to a broad-based index of

[1] *Source: FactSet Research Systems Inc.*

securities. The S&P 500 is comprised of a representative sample of 500 large-cap companies. The index is an unmanaged, float-weighted index with each stock's weight in the index in proportion to its float, as determined by Standard & Poors. The index is one of the most widely used benchmarks of U.S. equity performance. The index is not subject to any of the fees or expenses to which the LALCS Composite is subject. It is not possible to invest in this index. The index is used for comparison purposes only. It should not be assumed that the LALCS Strategy will invest in any specific securities that comprise the index or that the investment program of the LALCS Strategy will track the index. Consequently, the returns of the LALCS Composite may or may not be highly correlated with those of the index.

MSCI All Country World Index. The returns for the MSCI All Country World Index (“ACWI”) on a total return basis, that is, with dividends included and does not reflect the deduction of fees and expenses. The returns for the index are provided for comparison purposes only to show how the above composite returns compare to a broad-based index of securities. The MSCI AC World Index is composed of large and mid-capitalization developed and emerging market equities. The index is one of the most widely used benchmarks for global equity performance. You cannot invest directly in this index. It should not be assumed that the strategies above will invest in any specific securities that comprise the index or that the investment program of the strategies above will track the index. Consequently, the returns of the composites above may or may not be highly correlated with those of the index.

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Blended Benchmark. Is a hypothetical index comprised of 60% MSCI AC World Index and 40% the Bloomberg BarCap US Aggregate Bond Index. You cannot invest directly in this index.

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[1] *Source: FactSet Research Systems Inc.*