

CAN YOU TIME THE MARKET

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We preach investing for the long term to accomplish your objectives, but we're still human, so we understand the temptation to try to anticipate market movements and invest accordingly. Even though countless phrases warn against attempting to time the market, our emotions can still get the best of us during extreme market downturns and upturns. The recent uncertainty has given us the opportunity to have great conversations with a number of our clients about the difficulties of market timing. Disciplined investing is very easy when things are calm and the markets are peaceful. Unfortunately, discipline is only truly tested during moments of extreme volatility. That's the true testing ground of the disciplined investor. Over the long term, market returns need to be captured efficiently and consistently. Trying to guess when they occur is an impossibility that leads to the underperformance stated above. How difficult is it to time the market? Let's look. The chart below offers analysis into the potential consequences of failed market timing.

Reacting Can Hurt Performance

Performance of the S&P 500 Index, 1970-2015



In US dollars. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. **Past performance is not a guarantee of future results.** Performance data for January 1970–August 2008 provided by CRSP; performance data for September 2008–December 2015 provided by Bloomberg. S&P data provided by Standard & Poor's Index Services Group. US bonds and bills data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

That chart measures from 1970 to today, but since we are coming off of a bull market, let's handicap ourselves and only look from 1970 to 2008:

- The best single day of the period was October 13, 2008. The best one-month return, which came in October 1974, happened immediately after the worst one-year period.
- Strong positive returns are especially unpredictable. Ten of the top 25 days occurred between September 2008 and December 2008, during which time the S&P 500 dropped 28.9%
- The worst market day since 1970 occurred on October 19, 1987—just two days before the best day of the period. An investor who avoided the worst day would have earned a 10.10% annualized return, but missing the best day would have reduced the return to 9.18%.

If daily market returns are random, market timing is a coin flip. Investors who attempt to predict market drops are just as likely to miss out on strong return periods. This is also a double-edged sword because an investor has to be right twice – getting out of the market at the right time to miss the negative returns, and getting back in to catch the positives. The harsh reality of market efficiency, however, has not stopped speculators and other traders from attempting to read the future. On paper, market timing offers a seductive prospect: Who wouldn't want to capture only the best-performing days and avoid the worst? Obviously, if you miss the worst days your return will go up, but the chances of purposefully missing the bad days are as close to zero as you can get without saying zero. Attempting to time the market is like trying to walk across the interstate with your eyes closed and headphones on: You have no idea when it's safe to move. You might take a few successful steps, but that doesn't mean you should keep doing it.

Ultimately, combining the good and bad days nets a positive return. Our job as investors is to efficiently capture them. The task of cherry-picking days to be in or out of the market is daunting. The purpose of investing is to structure a portfolio to accomplish your objectives. It becomes anxiety-provoking to focus on the everyday market noise. As Woody Allen said, "90% of success is just showing up." In the market it pays to be present.

There were just over 11,250 trading days during the 45-year period from 1970 to 2015:

- Although missing the best day would have reduced only .0001% of the investment time horizon, it would have reduced the investment return by 3%.
- The best five days accounted for .0004% of the investment horizon, yet 10% of the investment return.
- The best 15 days accounted for .001% of the investment horizon, yet 23% of the investment return.
- The best 25 days accounted for .002% of the investment horizon, yet 33% of the investment return.
- And never getting in the market and investing in only One-Month T-Bills would have reduced the investment return by 52%.

One other thing to consider is that good and bad days often cluster together. After a large drop, you often see a good day that wipes out those losses. Take last year for example. In 2015, the Dow Jones Industrial Average's worst day was August 24, when it was down 588 points. Its best day was just two days later – on August 26, the index was up 619 points. If you were trying to avoid the worst day of the year, you would have probably missed the best day, too. Even worse, imagine if you had sold on the 25th – you would have locked in your losses and missed out on all of the gains. The biggest cost of market timing is the opportunity cost of missing out on market returns that are necessary for many investors to accomplish their objectives. The biggest “cost” of capturing these positive returns is the potential anxiety caused by remaining disciplined during volatile markets. Unfortunately, we don't get a “do-over” when we miss out on positive returns. Successful investing is truly about “Time in the markets, not timing the markets.” Yes, it's a cliché, but it is also a key tenet of a successful investment experience.