THE Wealth REPORT

IS IT TIME TO GET OUT OF THE MARKET?

Overview

The S&P 500 has enjoyed an eight-year bull market with an average annual return of 19.4 percent.[1] Some market analysts are warning that it may be due for a correction. But if investors pull out now, isn't that an attempt at market timing? If so, is market timing a viable strategy to help avoid loss?

Market timing is the tactic of jumping in and out of the market in order to take advantage of gains derived from rising prices and avoid losses when they decline. The problem with this strategy is that no one knows when prices will rise or decline. Furthermore, not all prices rise and fall together; some investments may remain stable despite dramatic movements among other securities.

Market timing as an investment strategy might make sense if you get a rush out of trying to outwit the market, perhaps by utilizing the services of a medium or soothsayer. But that's not a goal of the average investor.

Most people have more monetary-based goals, such as buying a home, funding a child's education or saving for retirement income in the future. Thrill seekers generally look somewhere other than the investment markets to fulfill their goals, like hang gliding. Unless you have a lot of financial security, market timing can be a risky proposition.

That's not to say getting in at the early stages of a share price increase and watching your earnings grow isn't a satisfying feeling; it most certainly is. But no investor — not even professionals like Warren Buffett — know with certainty if and when share prices will rise or fall. In fact, Mr. Buffett himself is a proponent of buying brands he knows and sticking with them over the long term — which is essentially the opposite of market timing.

"Buy into a company because you want to own it, not because you want the stock to go up."[2]

– Warren Buffett

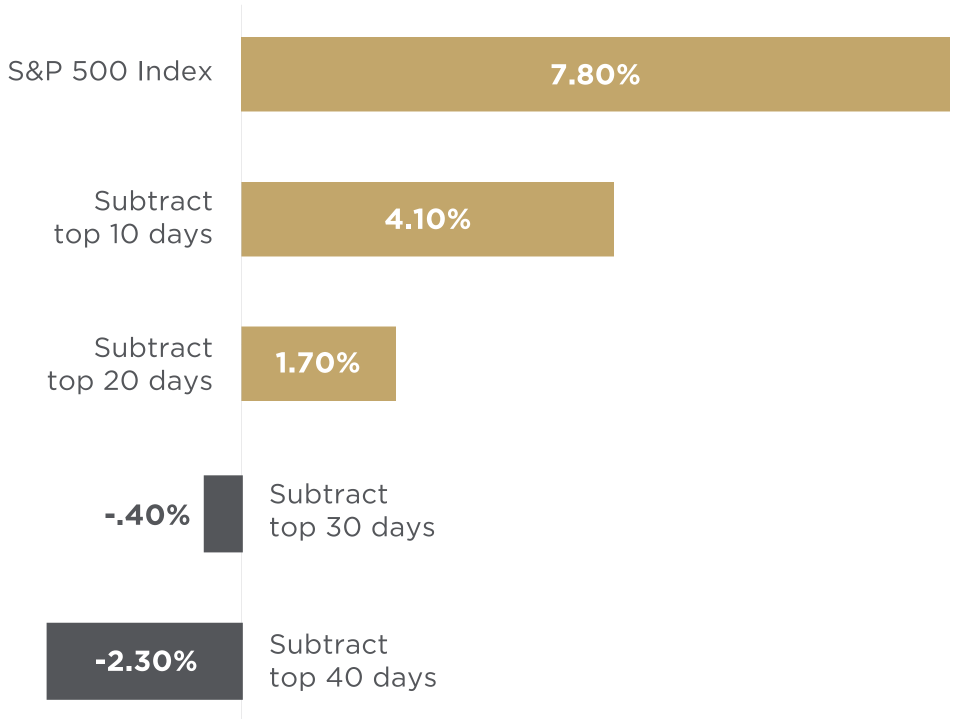
As a general rule, individual investors are known for impulsive behavior, often demonstrated by selling shares during periods of the greatest panic. This can take them out of the market during sudden turns that result in subsequent gains. Under this scenario, market timing is considered a behavioral finance issue in which investors are driven by emotions of fear or greed, and it often leads to poor results.[3]

Market Timing and Missed Opportunities

Why shouldn't investors protect their capital from the erosion of a bear market? For one thing, we usually don't know when a bear market will start or how long it will last. We don't know what specific securities will be affected. And if we stop automatically investing just because share prices have dropped, we may miss out on future gains when they rise — which is the basic premise that underlies successful investing.

In fact, history has shown that markets often reach their greatest heights just before a fall.[4] If investors sell too soon, they could miss out on the largest gains. If they don't get back into the market at the right time, they may miss out on more opportunities for increased gains — as demonstrated in the accompanying bar chart.

Standard & Poor's 500 Index Performance: 1996 - 2011[5]



"In investing, it is not necessary to do extraordinary things to get extraordinary results."[6]

– Warren Buffett

Market Timing Can Hurt Dividend Investors

Market timing may not bode well for many types of investors and investments, but it can be particularly detrimental for a retirement portfolio. For example, many dividend-paying stocks continue to pay out and increase dividends over time, even during a market correction. A significant advantage of dividend investing is that investors can continue to be paid while waiting out a period of share price declines. As a retiree, this source of income may be far more important than the current state of share prices.[7]

Market Timing Can Increase Investment Expenses

With market timing, there is the opportunity to grow additional earnings or avoid losses. However, this strategy also may incur additional costs, such as trading expenses and/or capital gains taxes.[8] The more an investor engages in market timing, the higher the expenses he's likely to incur. While an investor may have complete confidence that buying or selling based on market conditions will benefit his portfolio, it is important to weigh the potential advantages against these measurable expenses. When viewed from a cost perspective, market timing may yield a lower net gain than is worth the risk.

> *"Success in investing doesn't correlate with IQ ... what you need is the temperament to control the urges that get other people into trouble in investing."*[9]
>
> *– Warren Buffett*

Final Thoughts

Because the past eight years have been rather remarkable, some investors have come to expect strong market performance while the memories of past losses have faded. While it may not be in an investor's best interest to use market timing to sell before a pending correction, it's important to understand that losses are inevitable. Painful, but inevitable.

At the same time, a plunge in share prices offers additional opportunity for new investment growth. That doesn't mean swapping out investments; it means adding new money to them. It takes a certain, hard-core risk tolerance to add to a falling position. However, if you believe in the companies you're invested in; your asset allocation is appropriate for your goals; and you are in it for the long haul, buying while prices are low can be quite rewarding when the market recovers.

Whether you add to positions or not, many wealth managers recommend that the best course of action is to fasten your seat belt and ride through market turbulence. Remember, most bear markets tend to drop quickly but then recover just as fast.[10] For most investors, that is thrill enough.

---

[1] Rick Kahler. Investopedia. April 12, 2017. "Why Timing the Stock Market Is a Bad Idea." http://www.investopedia.com/advisor-network/articles/why-timing-stock-market-bad-idea/. Accessed Nov. 1, 2017.
[2] Dayana Yochim. USA Today. July 7, 2017. "5 Warren Buffett quotes can make you a better investor." https://www.usatoday.com/story/money/personalfinance/2017/07/07/5-warren-buffett-quotes-can-make-you-better-investor/453993001/. Accessed Nov. 1, 2017.
[3] The Wall Street Journal. Aug. 25, 2016. "The Emotions of Investing and More: The Experts Weigh In – At A Glance." https://blogs.wsj.com/briefly/2016/08/25/the-emotions-of-investing-and-more-the-experts-weigh-in-at-a-glance-at-a-glance/. Accessed Nov. 9, 2017.
[4] Rick Kahler. Investopedia. April 12, 2017. "Why Timing the Stock Market Is a Bad Idea." http://www.investopedia.com/advisor-network/articles/why-timing-stock-market-bad-idea/. Accessed Nov. 1, 2017.
[5] Michael Schmidt. Investopedia. 2017. "Buy-And-Hold Investing Vs. Market Timing." http://www.investopedia.com/articles/stocks/08/passive-active-investing.asp. Accessed Nov. 1, 2017.
[6] Dayana Yochim. USA Today. July 7, 2017. "5 Warren Buffett quotes can make you a better investor." https://www.usatoday.com/story/money/personalfinance/2017/07/07/5-warren-buffett-quotes-can-make-you-better-investor/453993001/. Accessed Nov. 1, 2017.
[7] Seeking Alpha. Feb. 7, 2017. "Market Timing Vs Time In The Market." https://seekingalpha.com/article/4043612-market-timing-vs-time-market. Accessed Nov. 1, 2017.
[8] Investopedia. "Market Timing." https://www.investopedia.com/terms/m/markettiming.asp. Accessed Nov. 9, 2017.
[9] Dayana Yochim. USA Today. July 7, 2017. "5 Warren Buffett quotes can make you a better investor." https://www.usatoday.com/story/money/personalfinance/2017/07/07/5-warren-buffett-quotes-can-make-you-better-investor/453993001/. Accessed Nov. 1, 2017.
[10] Rick Kahler. Investopedia. April 12, 2017. "Why Timing the Stock Market Is a Bad Idea." http://www.investopedia.com/advisor-network/articles/why-timing-stock-market-bad-idea/. Accessed Nov. 1, 2017.