Stay In Your Lane

CBIS
Catholic Responsible Investing

Market Timing Gets You Nowhere Fast

Every so often there's chatter about market timing — the urge to get out when prices are still relatively high, and re-enter when they're lower.

So, too, is the idea that market timing can be done successfully. But the reality is no one can. Why? Because no one has the edge or information advantage.

Fighting the Temptation

There's a parallel between changing lanes on a busy highway in pursuit of speed and tactical market timing in search of performance. The temptation to be in the "right lane at the right time" is a strong one. However, the combined efforts of other drivers attempting to do exactly the same thing likely makes it harder to get home sooner.

Likewise, shifting back and forth from stocks to bonds seems to offer potential for enhanced returns. In reality, though, the activity of countless other investors trying to outmaneuver the market at the same time makes it very difficult to boost returns with any degree of consistency.

There's no doubt that investors feel an urge to shift lanes in the markets from time-to-time, maybe lightening up on equities and moving into bonds. Some might even think about exiting markets all together. Regardless of one's market outlook, our belief remains the same: The temptation to change course should be avoided. The better route is to stay in your long-term asset allocation lane.

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Luck is Not A Strategy

We recognize that many investors feel certain they have a good read on the markets and hold great confidence in their convictions. We reviewed the history of large market movements and simulated the "success rate" required to generate performance in excess of an investor who follows a disciplined rebalancing policy. Here's what we found.

Since 1950, there have been 16 instances when the equity markets* experienced a peak-to-trough decline of more than 10%. The average of these events was -23%. Side-stepping these drops should lead to significantly higher long-term portfolio gains. Could an astute investor see a peak forming, exit, then re-enter the market after the bottom?

What we found was that a market timer who correctly forecast market declines of 10% or more within a six-month window would not have avoided even a bulk of the decline but would instead miss out on a 5.2% average gain. In other words, this investor — without perfect top and bottom timing — would have been right and still have been wrong.

*S&P 500

We then ran a statistical simulation to see just how successful a market timer would have to be to outperform a disciplined rebalancing strategy. The results indicated an investor who engages in timing with an assumed 50% chance of success each month significantly underperformed, on average, the rebalanced portfolio and with higher volatility. Not until the market timer's success rate exceeded 54% did the additional return compensate for the additional volatility.

We'll suggest a success rate of 54% is very difficult to achieve. The odds of consistent success are very low and the risk of failure and painful downside surprise are high.

Avoid the Temptation

In practice, we believe investors should stick to the allocation targets designed for their investment policy statements, no matter the market conditions. These policies were thoughtfully designed to achieve your goals for the long term and help you manage risk — and your emotions — for the short term.

Nothing we know of addresses market volatility like a disciplined investment policy. We believe it's the best way to capitalize on dynamic markets while reaching financial goals.

	Rebalanced Portfolio	Market Timing Portfolio		
	(50/50)	Probability of Success = .5	Probability of Success = .52	Probability of Success = .54
Median Annual Return	8.97	8.50	9.44	10.29
Standard Deviation of Return	3.73	5.33	5.32	5.32
95th Percentile	15.26	16.95	18.14	18.99
5th Percentile	2.81	-0.29	0.44	1.45
Median Sharpe Ratio	0.46	0.29	0.39	0.47

Source: Fact Set

Important Information

Contact Us

We want to hear from you!

If you have questions, please reach out to your CBIS representative:

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