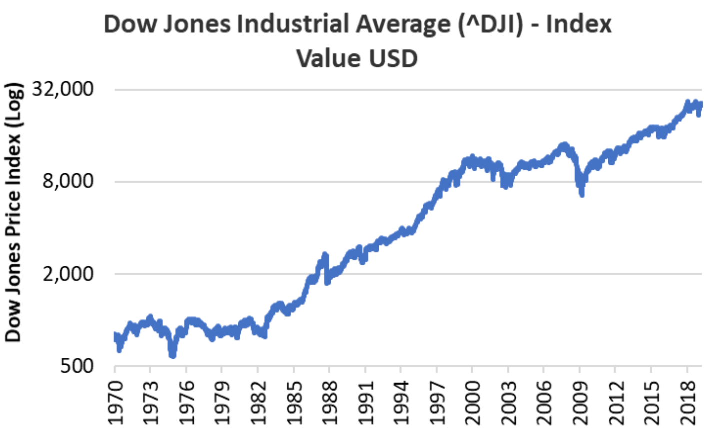
Katy Murdoch, CFA | Jason Reed, CFA, FCIA

Fallacy of Market Timing

The omnipresent news cycle lately sounds as if the end of days is near, covering topics like the inverted yield curve, Brexit delays causing further uncertainty, the US-China trade war and the longest bull market since WW2. While many of these headlines are interesting, they have little to no predictive power for markets. Paying too much attention to the ongoing narrative can entice some investors into short-term trading and taking extreme positions within their investment portfolios. Others may delay investing their cash in hopes that a correction is just around the corner.

If it were easy to make short-term calls on how the market would perform each year, extreme tactical portfolio shifts would be beneficial. Unfortunately, there is no crystal ball. Looking at the last 50 years of Dow Jones returns, even the most dramatic equity sell-offs (Black Monday, Dot-Com Bubble, Great Financial Crisis) start to look like mere bumps in the road. So why are so many investors caught up in trying to time the market?



Source: S&P Capital IQ

A study done by Fidelity looked at what would happen with $10,000 invested in the S&P 500 Index between 1980 and 2018 if investors tried to time the market. The results show that if you had stayed invested in the market for the entire period, your $10,000 would have grown to over $700,000 in 2018. However, if you had tried to hop in and out of the market and happened to miss the five best days, your portfolio would only be worth around $450,000. If you missed the best 10 days, your portfolio returns would have been cut in half. To properly time the market, you not only need to time your exit, but also your eventual re-entry. Furthermore, there is a tremendous psychological burden to navigating markets in this way.

The past few months are a great example of how difficult it is to time markets. In the first 16 trading days of December, the TSX fell almost 10%. To have avoided this drop and capitalize on this volatility, you would have needed to sell out entirely on December 1st, then turn around and rebuy on Christmas Eve when the markets bottomed. Hindsight is 20:20. Perfect execution of this trade would have been extremely unlikely. Why? Because no one knows when the exact bottom or top will be. Coupling this with the emotional element of re-entering after the market has fallen for 16 days makes winning the lottery almost more achievable. Luckily, for those investors who patiently rode out the volatility, the TSX rebounded to its December 1st level by mid-January, only 16 trading days after the bottom.

Private clients will often ask us if now is a good time to buy in this aging bull market. We believe clients in the wealth accumulation phase should generally be agnostic to market conditions. Their primary focus should be on their savings rate and on investing at regular intervals, a strategy known as dollar cost averaging. Under this approach, an investor buys the same dollar amount of an investment on a regular basis. This systematic and pragmatic approach to investing helps to neutralize short-term volatility, while increasing the likelihood of long-term success through numerous market entry points. Clients can implement this strategy by setting up a "PAC" (pre-authorized contribution) from their bank account. These automatic contributions promote diligent savings while providing opportunities to benefit from temporary downturns in the market.

A conservative portfolio asset mix, such as 50% equities & 50% cash/bonds, enables clients with regular cash needs to remain fully invested. Having enough liquid bonds to meet short-term spending needs helps to ensure clients never become forced sellers of equities in a bear market. Regardless of your stage in life or the stage of the market, we believe the best time to invest for the long term is now.

Copyright © 2019 QV Investors Inc. Readers may forward electronic versions of this Update. All views and projections are the expressed opinion of QV Investors Inc. and are subject to change without notice. This Update is provided for informational purposes only. QV Investors takes no legal responsibility from any losses resulting from investment decisions based on the content of this Update. **Click here** to subscribe to QV Updates.