The Madness of Market Timing

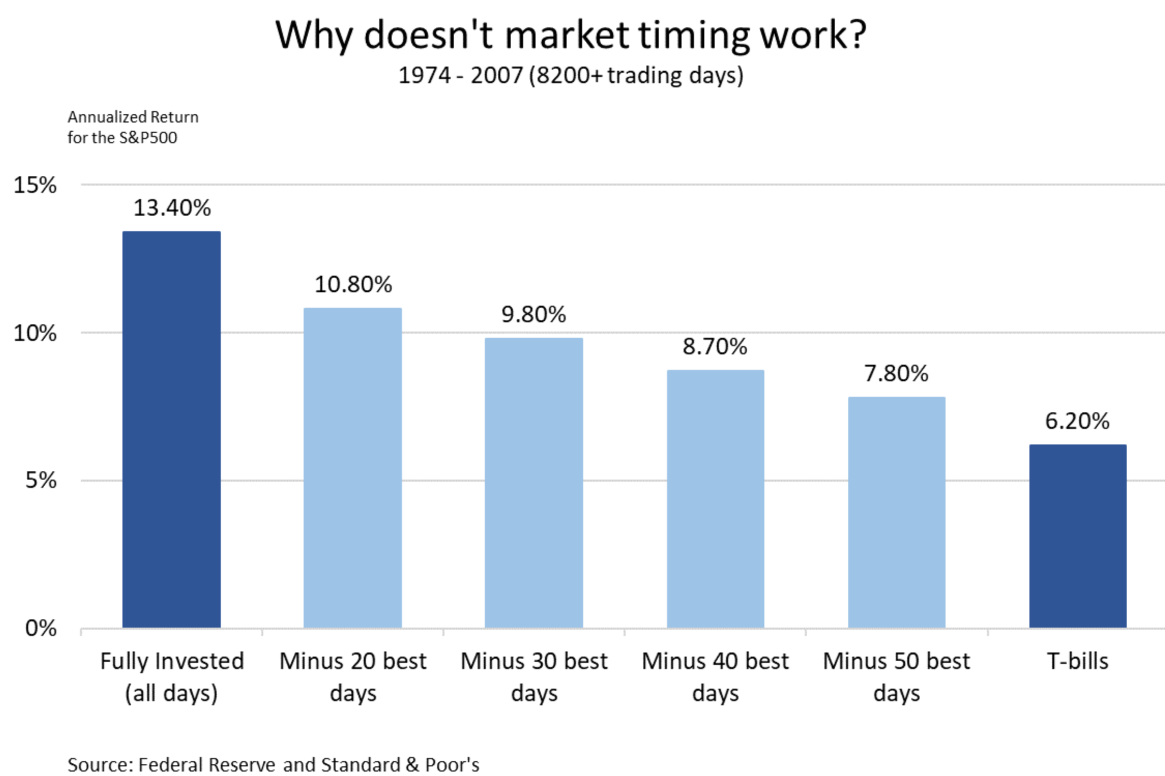
Nels Wangensteen November 6, 2018

The stock market is often compared to a roller coaster, complete with gut-wrenching drops, soaring climbs, and surprising twists and turns. Imagine trying to jump off a racing roller coaster car just before it plunged down a steep descent, then attempting to hop on again before the train began its rise up the other side. Your timing would have to be perfectly precise – twice. The odds are against a safe landing, and you are more likely to sustain a serious injury.

Yet that is just what investors who practice market timing attempt to do on a regular basis. They look to "jump off" the market train a just the right moment, and hop back on again, also at the perfect time. A thrilling prospect, but one that is fraught with danger.

Empirical evidence suggests that market timing is not a viable investment strategy.

Here is just one example of the value to be found in a more consistent investment strategy. If you bought into an S&P 500 index fund in 1998 and held onto it until 2017, you would have realized a 301 percent return on your investment. However, if you jumped out of the market and missed the five best days during that same period your return would be only 66 percent. And if you missed the market's 20 best days in those years your return would be a paltry 26 percent.[1]



1. "Should I wait out the market's volatility?" Matthew Frankel, CFP, USA Today, October 24, 2018

It is staggering to think that being out of the market for just a few days would have such a huge impact on performance. But the numbers prove it.

So, what is the appeal of market timing? Is it the visceral thrill of making a “big kill” in the market? I believe market timing relies on suspension of critical thinking that is necessary to succeed in an otherwise irrational market. Although long term trends have proven to be relatively independent of market activity, nervous or over eager investors may seek a shortterm solution to their angst.

This nervousness manifests itself as “bad news traveling faster than good news.” The market’s response to negativity is frequently much sharper and steeper than it is to positive information. That’s why it generally takes longer to recover from a plunge in market value that it does for the drop to occur in the first place. But the recovery has always come.

An argument can also be made that the allure of market timing lies in a distrust of the stock market that has its roots in the Great Depression. In the 1930s Wall Street was seen as the cause of the nation’s financial woes. It took decades for the “greatest generation” to get over this deep feeling of betrayal before once again being comfortable enough to reenter the market. More recent proof of this mistrust is shown in those investors who rode the Internet bubble until it burst. Many are still skittish and wary of technology companies and start-ups.

An honest assessment of investment strategies can only lead to the conclusion that a longterm commitment and patience with market variations will produce the best results over time. This does not mean adopting a “file and forget” mentality. The secret is to identify and capitalize on long-term trends by staying in touch with broader technological advances and social movements.

Roller coasters can be fun. But a short-term thrill is no match for a sustainable, solid return. Be careful before you leap into the unknown.

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