Ellacotts
Wealth Planning

Time in the market not timing the market

How many people have lost money trying to ‘play’ the markets? I do not know the definitive answer, but I know of at least one client who lost money during the Covid pandemic by coming out of the market at the wrong time and not going back in at the right time. Staying invested would have been the better option and not cost him as much.

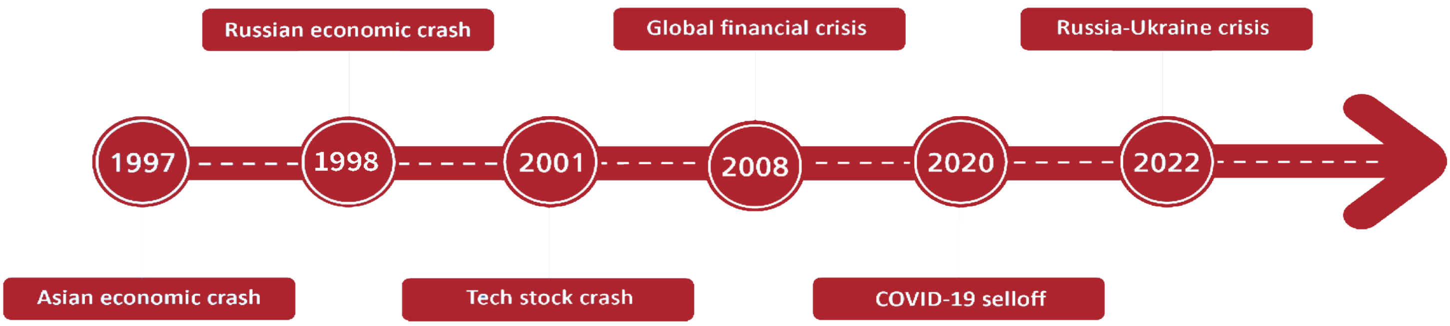
During periods of heightened financial market volatility, and increased levels of uncertainty, it can be tempting to try and time the market by selling assets and then buying them back at a later stage. However, timing the market is virtually impossible, even for the most experienced investors. This is why it's often said that time in the market is more important than timing the market.

Emotions and investing

Human nature can lead investors to be emotional about financial decisions. When markets dive, too many investors panic and sell; when stocks have had a good spell, too many investors go on a buying spree.

Past experience can lead to panic selling

People tend to ‘panic sell’ based on their past experiences. There have been six major crashes in the past 30 years, so psychology plays its part.



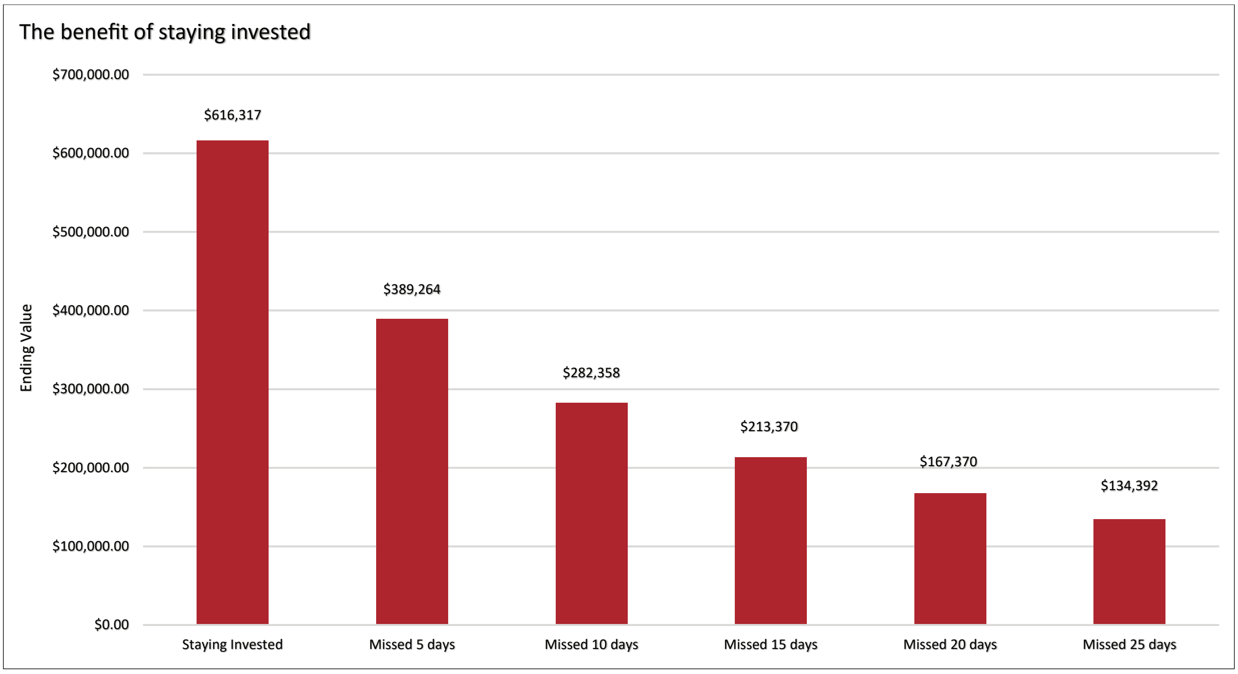
Source: LGT Wealth Management

It is never an easy ride on the way up in a bull market. Investors seem perpetually concerned, worried about the valuation levels, forever peering around the next corner and forever watching for the canaries in the coal mine that might signal the onset of the next market downturn. Prospect theory from behavioural finance suggests that investors are more likely to focus on gains rather than the perceived risk of loss when the outcome of an investment is uncertain. This ties into regret aversion and the fear of loss outweighing the joy of winning – hence many investors panic sell when the going gets tough. This is a large reason why investors are always encouraged not to look at their investments every day.

The issue with trying to time your entry/exit

The pace at which markets react to news means stock prices have already absorbed the impact of new developments and when markets turn, they turn quickly. Those trying to time their entry and exit may actually miss the market bounce. Attempting to predict the future, may mean you could end up being out of the market when it unexpectedly surges upward, potentially missing some of the best performing days. Missing one or two big days, compounded over time, can greatly impact your portfolio.

The graph below illustrates how a hypothetical $100,000 investment in the S&P 500 Index would have been affected by missing the market's top performing days over the 20-year period from 1 January 2002 to 31 December 2021. For example, an individual who remained invested for the entire time-period would have accumulated $616,317, while an investor who missed just five of the top performing days during that period would have accumulated only $389,263.



Source: BlackRock, Bloomberg

It's important to note, most of the best days happen around the worst days. Over the last 20 years, 70% of the best 10 days happened within two weeks of the worst 10 days (Source: Factset). If you were to incessantly go in, and out, of the market it would erode returns, alongside having tax implications and transaction costs.

It is true that a broken clock is right twice a day and hindsight is wonderful, but we are not soothsayers. If it was easy to time the market, lots of investors would be doing it and retiring early in the Bahamas, but this is not the case. We must remember that short-term volatility is the price you must pay for the chance of higher long-term returns and let the power of compounding take effect rather than potentially crystallising losses.

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