Time in the Market, Not Market Timing

Mar 22, 2015 | By Albert Meyer CA CPA

Cast your mind back to September 19, 2014. On that day the S&P 500 reach an intra-day record high of 2,019.26 and closed the day at 2,010.40.

The next day, the market went on an 18-trading day slide. By the close, on October 15, 2014, the market had pulled back a nerve-wracking -7.4%. On that day, the market reached an intra-day low of 1,820.66, which translated into a loss of -9.47% measured from the September 19 high. That was the critical point when buyers returned, so much so that by December 29, 2014, the market closed at 2,090.57 an increase of +12.2% from its close on October 15, 2014. It finally closed the year at 2,058.90, up +11.39% for the year as a whole and +10.5% from the close of the market on October 15, 2014 to year-end.

Observe that by October 15, 2014, the market had virtually given up all the gains of the year that were achieved up to September 19, 2014, and then it went on to fully recover over the next 53 trading days.

There is a warning in these numbers for those who think that they can time the market. Once the stock market experiences a couple of days of decline, the scaremongers come out of their holes and start warning about the next crash. Most people can handle a -2% to -3% decline, but once the market falls by more than -5%, dire warnings from the market motivate some investors to capitulate and sell out. This would most probably have been in the second week of October 2014. With that they kissed goodbye their 2014 returns. If they had any realized gains, they are now writing checks to the IRS. That's cash out the door, which has to be recovered by above-average returns in future years.

Let's assume some investors only cashed in half of their portfolios. How long would it have taken them to get back into the market? Let's be generous and say they were back in by November 15. Most investors who are easily scared out of the market would take much longer than a month to get back in, but let's give them the benefit of the doubt. Most of the bounce-back took place soon after the market bottomed, with a mere +0.93% return from November 15 to year-end. Do the math, and it becomes clear that anyone who sold half their portfolio during the second week of October and waited only a month to get fully invested again, would have posted a return of approximately +3.45% for the year, less than one-third of the +11.39% return of the S&P 500 for the year. This does not take into account potential tax payments on realized gains and brokerage commission on trades.

At the time of writing, the S&P 500 has advanced +15.86% since it reached its intra-day low on October 15, 2014. Only long-term investors enjoyed these types of returns. Those who time the market never publish verifiable returns, because their returns make for dismal reading. Next time the market retreats, keep in mind the adage: ***Time in the market, not market timing*** yields the best long-term returns.

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