Financial Gravity

Market Timing Looks Easy

One can look at the historical prices of the stock market and see that if stocks were bought on each decline that significant positive returns result. However, when one looks deeper, the issue of market timing becomes more complex, if not problematic.

What people often fail to consider is the opportunity cost of having that money on the sidelines available to invest during the decline. If money is to be available for investment when the market declines, that available money is almost certainly going to be uninvested for some period of time prior to the decline. As the stock market has risen over time and only suffers significant declines typically each five to ten years, how and when is the money taken out of the market to await the next decline? What is the cost of mistiming the full recovery? In the case of the period between the 2008 financial crisis and the 2020 covid crash the S&P 500 Total Return Index appreciated rather consistently for about 11 years and in the process had a return of about 450%.

How to pick the top?

How much in gains might be sacrificed by selling equities too soon?

When to buy back in?

Is planning to buy during a calamity when friends, family, media, and pundits are all panicking realistic or is barely hanging on to current equity positions more likely?

Unless you are able to run against the herd, and few investors are able to do so, then your expectation should be that when the market is turbulently falling that you are very unlikely to increase equity exposure.

Many investors sell during declines only to buy back in at higher prices when markets have calmed, thus costing themselves dearly. The consulting firm DALBAR has consistently found this practice to be the leading cause of the underperformance of retail investors.

The simple alternative to trying to time the highs and lows of the stock market is to accept that doing so is both unnecessary and extremely difficult and in some cases may lead to unwanted tax consequences.

Stock market returns over decades typically average about 10%, which is ample for most people to plan for a peaceful retirement particularly if the majority of those gains are tax deferred or otherwise managed efficiently.

You can look at the historical prices of the stock market and see that if stocks were bought at essentially any time in the past and held for decades that positive returns would have resulted. Accordingly, investors do not need to time the market to be successful. We usually recommend buying into the stock market and holding tight until your time comes to plan for retirement income, which we recommend doing about fifteen years prior to your target retirement date.

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