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Resist the Temptation to Time the Markets

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Article Background

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Investors in volatile markets are often gripped by the irresistible impulse to begin timing the market.

Who can blame them? On the surface, the case for market timing is deceptively appealing. By shifting out of equities into T-bills when markets are pricey, you can avoid losses in down markets and then simply shift back in near the bottom, capture most of the gains in the markets. Who doesn't want that? Consider the following.

First, virtually every significant study of market timing has concluded that it generally results in reduced returns.

Gary Brinson's landmark study in 1986 entitled "Determinants of Portfolio Performance" evaluated 91 pension funds over a 10-year period. On average, they lost 66 basis points (nearly two-thirds of a percentage point) a year by market timing. As a group, the pension funds would have been better off to just stick with their long-term strategic mix.

Second, a recent study in the winter 1996 issue of the Journal of Portfolio Management analyzing the prediction skills of market timers concluded : "luck and style variation tend to be just as important as the timer's skill." Do you really want your retirement monies managed by a method where luck is as important as skill?

Third, Dalbar Inc., a Boston consulting firm, compared the performance of actual investors in funds with the market return. They concluded that investors, on average, lost a staggering 4 to 5 per cent annually by attempting to time the market.

Many would-be timers don't realize that you have to be right twice to be right at all. You have to know when to leave and when to re-enter the market. The first decision to avoid a down market is difficult enough.

Finally, nobody has a track record of successful market timing.

However, just because market timing doesn't work, it doesn't mean you should just grit your teeth and hold on. You should:

1. Have a long-term plan with a customized asset mix that meets your needs.

2. Be automatically rebalancing back to your target mix whenever differential asset class performance throws your portfolio off target. This forces the discipline of selling high and buying low.

3. Use regular contributions to build your portfolio. Known as "dollar-cost averaging", regular contributions buy more investment units when markets are down, which lowers your average cost over time.

So quit worrying about market timing.

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