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BURKE
FINANCIAL STRATEGIES
An Independent Firm

TIMING THE MARKET

William J. Bernstein, esteemed financial author and theorist, once said “There are two kinds of investors, be they large or small: those who don’t know where the market is headed, and those who don’t know that they don’t know. Then again, there is a third type of investor – the investment professional, who indeed knows that he or she doesn’t know, but whose livelihood depends upon appearing to know.” We agree wholeheartedly with Mr. Bernstein, except that we will be the first to tell you that we don’t know where the market is headed.

Many of our clients now also fall into one of two camps: those that want to invest more aggressively in order to not miss out on further stock market gains, and those who are extra cautious thinking that stocks are now overpriced. Inherent in both thought processes is the belief that future stock market moves can be forecast. The urge to buy or sell in order to “time the market” is almost irresistible. It looks so easy in hindsight, and the difference in investment returns can be very significant. Unfortunately, attempting to time the market is a fool’s errand. John Bogle, founder of the Vanguard Group of mutual funds, wrote of market timing: “After nearly 50 years in this business, I do not know of anybody who has done it successfully and consistently. I don’t even know of anybody who knows anybody who has done it successfully and consistently.”[1]

Not only is it nearly impossible to consistently time the market, correctly doing so a majority of the time does not guarantee excess returns. This is true for a number of reasons. First, any extra returns would need to more than offset the extra transaction costs. Next, incorrect time out of the market provides zero return, which will need to be made up in other periods. And perhaps most importantly, missing the highest return days in the market is devastating. Shown below is a hypothetical example showing the annualized return of the S&P 500 index during the 20 year period from January 1, 1994 to December 31, 2013, and the value of a $10,000 initial investment into the index, compared to returns that would have been realized having missed days with the largest gains[2]:

$10,000 invested in the S&P Index	S&P 500 Annualized Return	Value of $10,000 at the end of period
• All 5,037 Trading Days	9.22%	$58,352
• Less 5 days with largest gains	7.00%	$38,710
• Less 10 days with largest gains	5.49%	$29,121
• Less 20 days with largest gains	3.02%	$18,146
• Less 40 days with largest gains	- 1.02%	$ 8,149

University of Michigan professor H. Nejat Seyhun analyzed 7,802 trading days for the 31 years from 1963 to 1993 and concluded that just 90 days (approx. 1% of trading days) generated 95% of cumulative market gains. For these and other reasons, Nobel Laureate William Sharpe concluded that a market timer must be correct 74% of the time in order to outperform a steady portfolio at a comparable level of risk.[3]

We believe in a holistic approach to investing. We start with a clear understanding of goals. We assess attitudes towards risk and we consider Investment time horizons. With this information, we then work to tailor personalized, diversified portfolios. Such a diversified portfolio may help reduce overall volatility and mitigate risk. We know that investors have an easier time sticking with an investment program when large swings in a portfolio are minimized.

Diversification can help a portfolio navigate through market volatility. Many professional investors understand this. Just ask Jane Mendillo, CEO of Harvard Management. She oversees the $32.7 billion Harvard endowment. Shown below is a breakdown of this portfolio at December 31, 2013:[4]

- U.S. equities 11%
- Foreign (developed market) equities 11%
- Emerging market equities 11%
- Private equities 16%
- Hedge funds (unavailable to retail investors) 15%
- Public commodities 2%
- Natural resources 13%
- Real estate 10%
- Domestic bonds 4%
- Foreign bonds 2%
- High yield bonds 2%
- Inflation indexed bonds 3%

The Harvard endowment is in the market. So are we. And other than some tactical shifts across asset classes and some rebalancing after a strong year in equities, we intend to stay in the market. In our view, an investment that includes a healthy allocation to equities provides the best opportunity to keep pace with or exceed inflation over the long term.

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[1] The John C. Bogle Reader
[2] Index Fund Advisors – http://www.ifi.com/12steps/step4
[3] "Likely Gains from Market Timing," Financial Analysts Journal, March/April, 1975
[4] "Lessons Learned at Harvard," Barron's, February 3, 2014

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