Don’t Try to Time the Market

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I noticed a recent headline in *Financial Advisor Magazine* that reminded me of a basic investing truth that I have observed throughout my 30-year career: It’s virtually impossible to time the market.

The article, dated January 28, 2019, is titled “Fund Investors Took Cover in Fixed Income in 2018.” The article says that mutual funds experienced $131 billion of net outflows in the month of December 2018 alone. A net fund flow is the net of all cash inflows and outflows in and out of a fund for a specified period of time. Therefore, mutual fund investors took out $131 billion more than they put into all mutual funds in December.

Overall, U.S. mutual funds collected just over $157 billion in inflows in 2018 according to MorningStar, which tracks these numbers on a monthly and annual basis. This is the lowest inflow of any calendar year since 2008.

It’s likely no coincidence that these massive fund net outflows occurred during the worst December for stocks since the Great Depression. In December last year, the Dow Jones Industrial Average fell 9.7 percent, the NASDAQ Composite dropped 10.4 percent and the S&P 500 declined 10 percent.

The steep declines in the month of December have been attributed to a number of different factors including:

- The Federal Reserve’s apparent commitment to systematically raise interest rates over the coming quarters and a further commitment to unwind years of quantitative easing;
- Ongoing trade negotiations and a threat of a trade war with China;
- Uncertainty created by the federal government shutdown;
- Some warnings from major U.S. companies about near-term profit outlook.

Regardless of the reasons for the sharp declines in the month of December, the question is: Did those investors who exited the market in a significant way in the month of December make the right decision? Well, consider this headline from CNBC dated January 31, 2019 — “The Best January in 30 Years Could Mean Good Things for The Stock Market In 2019.” Yes, that’s right the best January in 30 years. In January 2019, the S&P 500 jumped 7.9 percent. That was the best January since 1987, when the index rose 13.2 percent in a single month.

So, why the sudden turnaround in the month of January? A number of factors may have contributed to the excellent market performance in January, including:

- A scorching job market with 304,000 new jobs created in the month of January, well above the 165,000 jobs expected by economists;
- Wage growth accompanied strong job creation;
- Economic activity in the important manufacturing sector expanded in January. The ISM Manufacturing index, an important gauge of this sector, registered 56.6, well above the estimate of 54.2 and the 50-mark that reflects economic expansion.
- The Federal Reserve indicated a willingness to pause its interest rate hikes and stated that these decisions would be dependent upon economic data and market conditions;
- Corporate earnings, although relatively weak this quarter, have been stronger than expected.

To be sure, the purpose of this article isn't to analyze these dramatic market swings. Rather, the point is that most people can't time the market and recent fund flows relative to market performance reinforce this truth. (If you are interested in more specific market analysis, our firm's chief investment officer and investment policy committee provide regular monthly summaries of market performance and the outlook for the capital markets.)

Unfortunately, for those who did sell in the month of December, it is all too likely that they missed all or a significant portion of the January rebound. Because of the nature of how the capital markets work, by missing the month of January, they may have missed out on most of the returns for 2019. It is actually quite common for the bulk of the returns in a financial asset for any given year to come over a relatively short period of time, often as little as a few weeks or one month.

It is even more likely that many of those investors who exited the market in the month of December are in fact still sitting on the sidelines trying to make a decision that is often more difficult than panic selling. These investors are now asking themselves: When do I get back in?

DALBAR, a financial research firm, has compared the performance of various market indices to the average equity and fixed income investor for many years. The results are very consistent: The indices typically outperform the average equity investor by approximately 2 percent. This is very likely due to the temptation that the typical investor has trying to time the market, fleeing the market at the bottom and rushing into the market at the top. This is exactly what we witnessed over the last 60 days.

As wealth-management professionals, we recommend a more thoughtful approach:

- Develop a broad, globally diversified asset allocation designed to give you the greatest probability of accomplishing your long-term goal;

- Select high quality, low-cost money managers within each respective asset class and monitor their performance carefully relative to their peer group;
- Carefully re-balance your portfolio back to your target allocation when asset-class weightings exceed your tolerances;
- Be cognizant of the impact of income taxes on your portfolio. For example, you might consider putting one asset in a taxable account and another in a tax-deferred account such as an IRA because this decision can have a significant impact on your after-tax returns.

And of course, at HBKS® Wealth Advisors, we continue to believe that an experienced team of financial and wealth advisors can help our clients mitigate the temptation to make emotional trading decisions that can materially impact their ability to accomplish their long-term goals.

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Dean Piccirillo is a principal and senior financial advisor at HBKS® Wealth Advisors. Dean is responsible for the firm's Retirement Plan Services Unit on a national basis. The Retirement Plan Unit helps plan sponsors establish or enhance qualified retirement plan such as 401(k)s. Dean writes online about retirement and financial planning matters at www.deanpiccirillo.com.