Eagle Strategies LLC

Investment

PLANNING ESSENTIALS

The Costs of Market Timing

Why doing less is often better

KEY TAKEAWAYS:

1. **Trying to time the market is a surefire route to investment frustration.** If you were on the sidelines for just five key days over the past 40 years, your portfolio would be worth 38% less.

2. **Both our emotions and the current speed of technology are working against us** when we try to outmaneuver other investors.

3. **The best course of action is using tried-and-true principals of sound investing**—diversification, asset allocation, and risk management—combined with a commitment to dollar cost averaging.

During a market decline, no one enjoys sitting idly by watching their 401(k) account balances steadily decrease month after month. Nor do we like staying the course with our 60% stock and 40% bond balanced portfolio allocation when markets surge—as we hear friends talk about how they have doubled their savings by investing all their money in stocks like Tesla, Amazon, or the latest "stock du jour."

Patience is a virtue, but it is a virtue that can be emotionally challenging, and at times, downright frustrating. There is a Warren Buffett quote that captures the reason why patience is an essential quality for long-term investment success:

"The stock market is a device for transferring money from the impatient to the patient."

Market timing (attempting to buy low and sell high) is a veritable recipe for investment disappointment—and there are three critical reasons why those who do it often regret the decision.

1. If your timing is even off a little, it can cost you big.

We all wish we had the gift of foresight—being able to sell our stocks right before a major downturn and then buying them back at the start of a recovery. Unfortunately, none of us has a financial crystal ball. But even if you were a visionary, or lucky enough to anticipate trends, mis-timing your purchases and sales by just a few days could make the difference between reaching and falling short of your investment goals.

As the following chart from Fidelity illustrates, missing just the five best days of market performance over a 40-year investment period would have reduced your portfolio return by 38%. Missing the 30 best days would slash your return by 84%.[1]

2. Emotions drive us toward 'buy high–sell low' behavior.

It is a fundamental aspect of human nature that we allow emotions to cloud our judgment. In fact, there's an entire field of study (i.e., behavioral finance) dedicated to better understanding why people tend to make bad decisions when it comes to money.

We seem instinctively drawn to new trends (*herding bias*), which appears to be partly hardwired into our DNA, and partly driven by our fear of missing out. We also tend to consistently overestimate our individual abilities and the likelihood of positive things happening to us (*overconfidence bias*). This reliance on feelings and instincts—rather than evidence and facts—is the antithesis of rational behavior, which is required to make sound financial decisions.

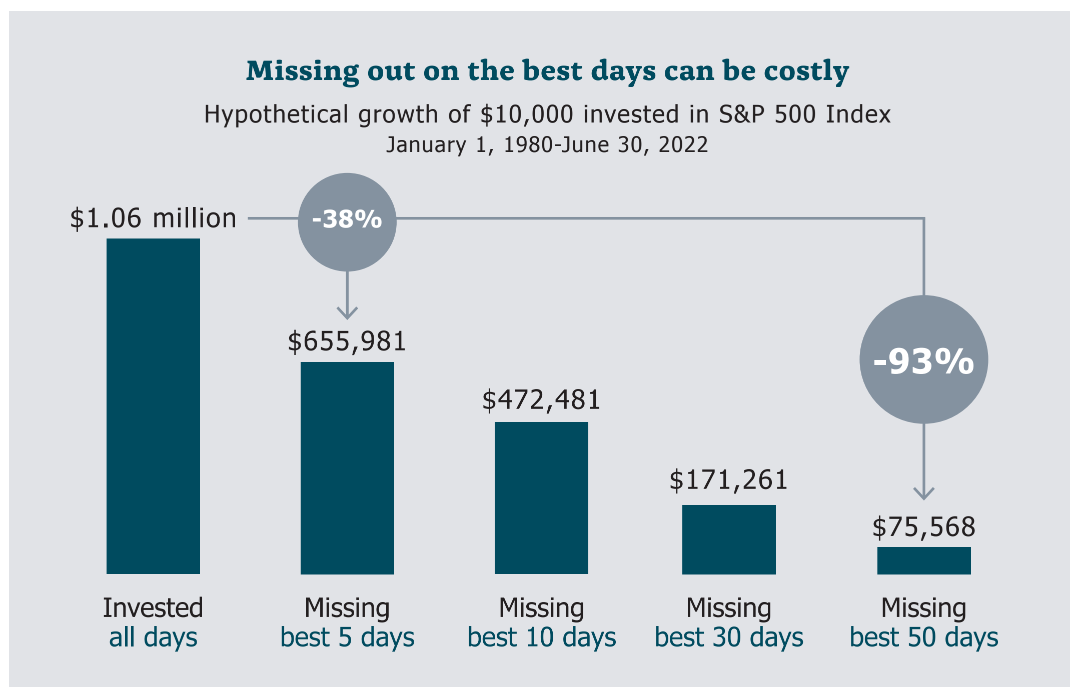

Chart Source: "6 Tips to Navigate Volatile Markets," Fidelity Viewpoints, January 2024.

3. Technology is NOT your trading friend.

Thirty years ago, you could read the Wall Street Journal in the morning and come across an investment idea; call your stockbroker after lunch to place a trade; and still have an information advantage over other investors. Today, that is no longer the case for even the savviest individual investors.

With instantaneous electronic trading driven by sophisticated algorithms that analyze thousands of data points in a fraction of a second, it is impossible to keep up or compete with large institutional investors and hedge fund managers—no matter how experienced or knowledgeable you may be.

Why boring may be better

Studies have shown that when a market downturn hits, it is easier for investors to hold on to more "vanilla" investments, like broad index funds, than to stick with high-flying and more volatile stocks, or other holdings. Since they tend to prevent you from making rash, ill-timed decisions, these so-called boring portfolios can also keep your trading costs and fees in check by reducing the frequency of buying and selling.

Along with not giving in to either fear or greed during market turbulence, the proven strategy of *dollar cost averaging* offers a greater likelihood of long-term investment success than trying to time the market. Dollar cost averaging is a strategy of systematically and consistently adding to your investment portfolio every month—similar to how your pre-tax dollars are contributed to your 401(k) each pay period.

Dollar cost averaging is a sustainable approach for all market conditions—especially during market downturns. Why? Assume that every month you add $500 to your investment portfolio to buy an S&P 500® index fund. If the market is soaring this month, the investment can buy 10 shares at $50/share. If the market drops 25% next month, the same $500 you add to your account will be able to buy more (13.3) shares at the reduced $37.50/share price. Essentially, anytime the market undergoes a correction, your monthly investments are taking advantage of the reduced prices to accumulate more shares before the next upcycle.

Tune out the noise

Of course, having accurate and timely information is critical to making sound financial decisions. But we live in an age where financial news networks inundate us with 24/7 market predictions and investment recommendations—almost always delivered by either euphoric or panicked "experts." During times of economic uncertainty, it can be enough to push anyone over the edge.

The simple truth is that no amount of data is going to provide you with a crystal ball to forecast the day-to-day movements of financial markets. Instead, rely on the human advice and guidance provided by your trusted advisor as well as the core tenets of sound investing—diversification, asset allocation, and thoughtful risk management. Let the power of time and historical market growth take care of the heavy lifting for you.

[1] "6 Tips to Navigate Volatile Markets," Fidelity Viewpoints, January 2024.

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