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RESEARCH ABSTRACT

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Market Timing: Opportunities and Risks

by Wim Antoons

Strategic asset allocation has been the most important driver of long-term investment success; the long-term odds are not in favor of market timing strategies.

It is often noted that a very small proportion of high volatility days can account for the equivalent of substantially all long-term returns. But a strategy of trying to invest on the "best days" and avoid the "worst days" would be virtually impossible to execute.

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In the full paper, we show that the advice of market timing newsletters was generally wrong more than right, and that mutual fund investors on average historically have tended to underperform the returns of the funds in which they invest, largely due to poor timing of buy/sell decisions.

Investors face behavioral challenges in market timing as they tend to be poor forecasters, yet are overconfident in the accuracy of their forecasts.

Additionally, any market timing strategy is likely to increase both trading and opportunity costs.

In general, market timing could be detrimental to a sound and disciplined investment process; we believe any tactical asset allocation (market timing) should be strictly disciplined and limited in scope.

Strategic asset allocation involves setting target allocations for various asset classes—based on factors such as time horizon, long-term investment objectives and risk tolerance—and periodically rebalancing a portfolio when it deviates from the allocation settings. Strategic asset allocation is compatible with a "buy-and-hold" strategy.

Tactical asset allocation is an active portfolio strategy that seeks to take advantage of market pricing in the short term.

Market timing is the process of attempting to predict the future direction of the market and switching between asset classes and cash with the goal of profiting from changes in market outlook.

Exhibit 1 (see following page) examines monthly returns for the S&P 500 Index from January 1961 to the end of December 2015. The results are compelling. The buy-and-hold investor would have realized an annual return of 9.87%.

The perfectly accurate market timer who avoided the 25 worst trading days would have generated an annual return of 15.27%, before fees and taxes. However, the investor who missed the best 25 days realized an annual return of only 5.74%.

Seeing the potential benefits of missing the worst-performing days may tempt investors to try to time the market. However, deeper analysis shows that long-term returns were actually realized in very short periods of time. Returns for the best 81 trading days during the period (out of 13,844 trading days) would have equaled the

Exhibit 1: The Lure of Market Timing: Avoiding the Worst Days Would Have Outperformed Buy and Hold
The Results of Market Timing for the S&P 500 Index (1/1/1961 to 12/31/2015)

	Annualized Return (%)	Growth of $100
Missing 25 Best Days	5.74	$831
Missing 25 Worst Days	15.27	$21,886
Buy and Hold	9.87	$3,550
Missing Worst & Best Days	10.94	$5,125

Source: S&P 500 Index via Bloomberg, as of 12/31/15. Past performance is not a guarantee of future results. One cannot invest directly in an index. Does not reflect the effects of fees and taxes.

total return for a buy-and-hold investor over the entire period. In other words, with perfect foresight, being invested only 0.59% of the time would produce the same results as if an investment were held over the entire 55-year period. Or, from a different perspective, had one missed these 81 best-performing days, the annualized return during the period would fall to a meager 0.03%.

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About the Author

Wim Antoons is Head of Asset Management at Bank Nagelmackers and a member of the Brandes Institute Advisory Board. At Nagelmackers, he oversees the investment process for the private banking and fund of funds businesses. He established the firm's value investment philosophy and its open architecture fund platform. He is also co-manager of the Nagelmackers Funds and manager of the Nagelmackers Privilege Fund. Before joining Nagelmackers, he worked for 6 years in the unit-linked business at Fortis Bank Insurance, responsible for the selection of value equity funds.

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