

Focus on Time in the Market, Not Market Timing

Why a “buy-and-hold” investment strategy can make sense

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RISK MANAGEMENT

Sports commentators often predict the big winners at the start of a season, only to see their forecasts fade away as their chosen teams lose. Similarly, market timers often try to predict big wins in the investment markets, only to be disappointed by the reality of unexpected turns in performance. It’s true that market timing sometimes can be beneficial for seasoned investing experts (or for those with a lucky rabbit’s foot); however, for those who do not wish to subject their money to such a potentially risky strategy, time — not timing — could be the best alternative.

What Is Market Timing?

Market timing is an investing strategy in which the investor tries to identify the best times to be in the market and when to get out. Relying heavily on forecasts and market analysis, market timing is often utilized by brokers, financial analysts, and mutual fund portfolio managers to attempt to reap the greatest rewards for their clients.

Proponents of market timing say that successfully forecasting the ebbs and flows of the market can result in higher returns than other strategies. Their specific tactics for pursuing success can range from what some have termed “pure timers” to “tactical asset allocators.”

Pure timing requires the investor to determine when to move 100% in or 100% out of one of the three asset classes — stocks, bonds, and money markets. Perhaps the riskiest of market timing strategies, pure timing also calls for nearly 100% accurate forecasting, something nobody can claim.

On the other hand, tactical asset allocators shift their portfolio’s weights (or redistribute their assets among the various classes) based on expected market movements and the probability of return vs. risk on each asset class. Professional mutual fund managers

who manage asset allocation funds often use this strategy in attempting to meet their funds’ objectives.

Market Timing Has Its Risks

Although professionals may be able to use market timing to reap rewards, one of the biggest risks of this strategy is potentially missing the market’s best-performing cycles. This means that an investor, believing the market would go down, removes his or her investment dollars and places them in more conservative investments. While the money is out of stocks, the market instead enjoys its best-performing month(s). The investor has, therefore, incorrectly timed the market and missed those top months. Perhaps the best move for most individual investors — especially those striving toward long-term goals — might be to purchase shares and hold on to them throughout market cycles. This is commonly known as a “buy-and-hold” investment strategy.

As seen in the accompanying table, purchasing investments and then withstanding the market’s ups and downs can work to your advantage. Though past performance cannot guarantee future results, missing the top 20 months in the 30-year period ended December 31, 2006, would have cost you \$28,379 in potential earnings on a \$1,000 investment in Standard & Poor’s Composite Index

of 500 Stocks (S&P 500). Similarly, a \$1,000 investment made in 1997 and left untouched through 2006 would have grown to \$2,245; missing only the top 20 months in that 120-month span would have cut your accumulated wealth to \$594.¹

Though many debate the success of market timing vs. a buy-and-hold strategy, forecasting the market undoubtedly requires the kind of expertise that portfolio managers use on a daily basis. Individual investors might best leave market timing to the experts — and focus instead on working with a professional advisor to help them prioritize and achieve their personal financial goals.

Use Time to Your Advantage

If you’re not a professional money manager, your best bet is probably to work with a professional advisor to construct an investment plan designed to help you meet your specific financial goals, then invest according to that plan. Through a buy-and-

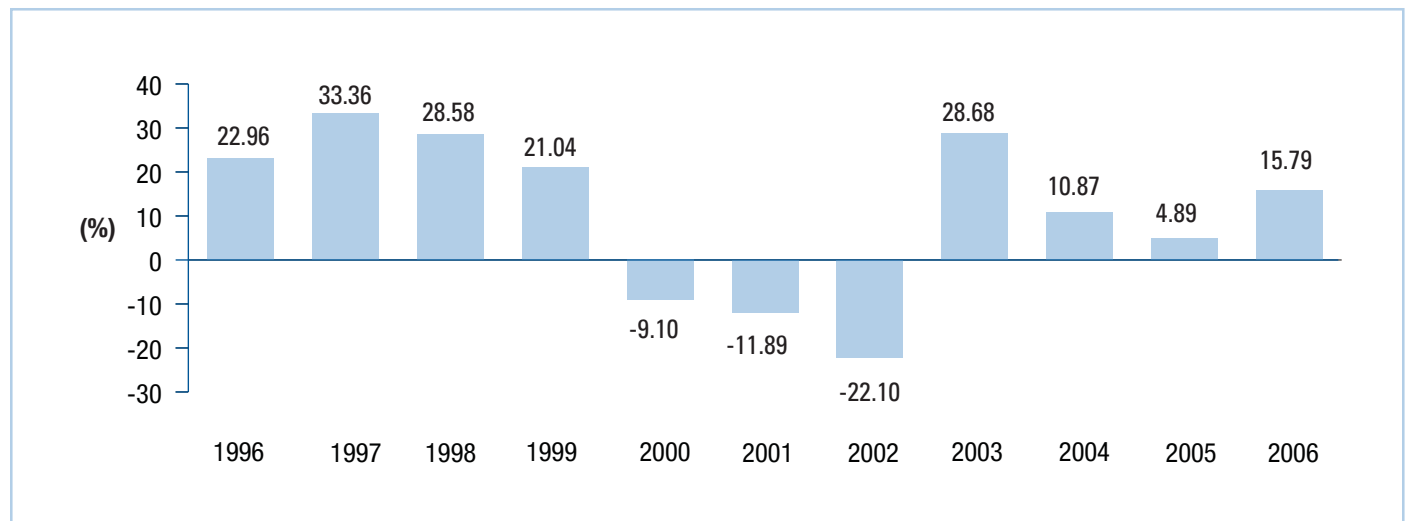
	A 1977 - 2006	B 1987 - 2006	C 1997 - 2006
1. Untouched	\$34,084	\$9,316	\$2,245
2. Miss 10 Top-Performing Months	\$12,249	\$3,786	\$1,057
3. Miss 20 Top-Performing Months	\$5,705	\$1,925	\$594

As this graphic shows, perhaps the most significant risk of market timing is missing out on the market’s best-performing cycles. Columns A, B, and C represent the growth of a \$1,000 investment beginning in 1977, 1987, and 1997, and ending December 31, 2006.

Row 1 shows the investment if left untouched for the entire period shown above; Row 2 shows the investment if it was pulled out during the 10 top-performing months; and Row 3 shows the investment if it was pulled out during the 20 top-performing months.

hold strategy, you take advantage of the power of compounding, or the ability of your invested money to make money. Compounding can also help lower risk over time: as your investment grows, the chance of losing the original principal declines.

Total Annual Return of the S&P 500



Source: Standard & Poor’s. Based on the total annual returns of the S&P 500.

Regular Evaluations Are Necessary

Buy and hold, however, doesn't mean ignoring your investments. Your financial advisor should provide you regular portfolio checkups, making sure your plan is on track to meet your goals and to discuss whether your investment needs have changed over time.

Normally a young investor will probably begin investing for longer-term goals such as buying a house, children's education and retirement. The majority of his/her portfolio will likely be in stocks and stock funds, as history shows those have offered the best potential for growth over time. Of course, they have also experienced the widest short-term fluctuations (see chart above). Retirees, on the other hand, may be more focused on generating income to live on and achieving various legacy goals such as charitable donations and trusts. Remember, though, that even those enjoying retirement should consider the historical inflation-beating benefits of stocks and stock mutual funds, as people often live 20 years or more beyond their last official paycheck.

Time Is Your Ally

Clearly, time can be a better ally than timing. The best approach to your portfolio is to identify and prioritize your unique goals and dreams, and work with a professional financial advisor focused on helping you achieve those objectives through a tailored investment plan. Above all, remember that constructing and implementing an appropriate plan is generally a far better approach than trying to time the inevitable ups and downs of the financial markets.

Points to Remember

1. Historically, a buy-and-hold strategy has resulted in significantly higher gains over the long run, although past performance is not indicative of future results.
2. A big risk of market timing is missing out on the best-performing market cycles. Missing even a few months can substantially affect portfolio earnings.
3. Market timing strategies — which range from putting 100% of your assets in or out of one asset class to allocation among a variety of assets — are based on market performance expectations.
4. Though buy-and-hold is a smart strategy, regular portfolio checkups are necessary to make sure your plan is on track to meet your goals.
5. Riskier investments are more appropriate for longer-term goals, and as goals get closer, portfolios should be adjusted accordingly.
6. Even in retirement, portfolios should contain investments for earnings to keep pace with inflation.
7. You should work with a professional financial advisor when creating and implementing an investment plan designed to help you achieve your specific financial goals.

For more information, please consult with your financial advisor.

Important Additional Notes

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1 Source: Standard & Poor's. Stocks are represented by Standard & Poor's Composite Index of 500 Stocks, an unmanaged index generally considered representative of the U.S. stock market. Individuals cannot invest in indexes. Past performance is no guarantee of future results.

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Growth of \$1,000: A graphical measurement of a portfolio's gross return that simulates the performance of an initial investment of \$1,000 over a given time period.

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