

A Message Worth Repeating

Overview: Stay the course. We repeat that advice again and again. It is a message we would not repeat if we did not truly believe it was in your best interests. The following discusses why our message is the same regardless of market conditions.

Our advice has always been — and will always be — based on the scientific evidence, not on our opinions about where the markets may be headed.

In light of the recent market drop, it is no wonder many investors seem to be worn out and wary of the market. Investors experience a rally, only to see another crisis and another dramatic drop. Making matters worse, the yields on safe, high-quality fixed income investments (the only kind you should consider) have risen, causing prices to drop.

What is an investor to do? Our advice is simple: If you have a well-developed plan, one that doesn't take more risk than you have the ability, willingness and need to take, then you should stick to it.

Market Efficiency

For us to believe that we should abandon a long-term, buy-and-hold strategy, we would have to first be convinced that markets are no longer efficient, that the market is now mispricing assets and is reacting slowly to new information. It is hard to imagine that markets have gotten slower at reacting to news. In fact, markets incorporate news into prices almost instantaneously. We believe the market was and continues to be highly efficient, and we encourage investors to keep the longer term in mind.

Market Timing

As for trying to time the market, we again rely on the historical evidence. When a client suggests just getting out until things are clear again, we point out that the evidence on market timing is even worse than on stock selection.

One reason market timing fails is because so much of the market's return occurs during very brief and unpredictable periods. Recall the litany of problems the markets faced from March 9, 2009, through March 30, 2011. There was never a green light letting investors know it was safe. It was red the entire time. That's why investors were pulling out hundreds of billions of dollars from the market, and many missed the greatest rally since the 1930s when the S&P 500 provided a return of more than 100 percent.

Another reason is because investors have to be right not once, but twice. Deciding to get out is easy compared with deciding when to get back in. Investors who go to cash may be “whipsawed.” They will get out after a severe drop, miss a big rally and jump back in only to experience another severe loss. They end up worse than if they simply stayed the course.

What are the chances an investor can succeed following this pattern of jumping in and out of the market? That is the problem with trying to time the market.

The Difference Between Information and Wisdom

We can define information as facts or opinions. In terms of investing, wisdom is information that can be exploited to generate excess (above market) profits. When we ask people why they are so willing to abandon their well-designed plan, they say something like: “Isn’t it obvious that the situation is terrible?” The question they fail to ask is this: If it is in fact obvious, isn’t the bad news already built into prices?

Many investors considered selling in 2011 and 2012 because of concerns about the Greek crisis, more recently, the fear of contagion throughout Europe and concerns about the U.S.’s long-term financial stability and health. The emotions created by crises cause us to lose perspective — like forgetting that fairly regular crises are actually the norm. Should investors sell? To answer that question, one must understand these concerns are well known by the market and are already reflected in prices. As Wall Street legend Bernard Baruch once stated, “Something that everyone knows isn’t worth knowing.”

Summary

It can be difficult to hear the message to stay the course. But it is a message worth repeating because it is the best advice. History provides us with that evidence. Thus, our advice will continue to be the same, because the science demonstrates that this is the most likely way to achieve one’s goals.

This material is derived from sources believed to be reliable, but its accuracy and the opinions based thereon are not guaranteed. The content of this publication is for general information only and is not intended to serve as specific financial, accounting or tax advice. To be distributed only by a Registered Investment Advisor firm. Copyright © 2013, The BAM ALLIANCE.