HANOVER ADVISORS

The Myth of 'Playing' the Market

Investing is often referred to as "playing" the stock market, and this is how many investors approach their investment strategy. Like a game of chess, each move in the market is closely watched, and investors, with the adage "buy low, sell high" ringing in their ears, carefully consider their every action, hoping to find the right move that will send their returns through the roof. The unfortunate reality is that this style of investing is far more likely to result in losses than gains.

Since 1994, economic analysis firm DALBAR has tracked the returns for the average investor and compared them to returns for the market as a whole. The most recent DALBAR study showed the average investor's performance over the last 20 years, and the results show just how hard "playing" the markets can be. In the period from 1998 to 2018, the average investor underperformed all but two of the 43 asset classes that were examined. The average investor didn't manage to keep pace with inflation, meaning that in real money terms, they actually saw a negative return. They even fared slightly worse than cash, meaning that they would have been better off just keeping their money in the bank.

DALBAR points to one reason for this discrepancy, and that is emotion. Investors panic at every downturn in the market. More often than not, they pull their money out at the wrong moment. While they hope they can avoid losses, they usually end up missing the recovery, resulting in lower returns than if they had just stayed put. In 2018, the S&P 500 was down 4.38

percent. The average investor lost more than double that, with a 9.42 percent decline. This lag behind the market occurs in good times as well as bad. August 2018 saw the S&P return 3.26 percent, but the average investor returned just 1.8 percent. This shows just how bad investors can be at timing the market, and how much better off they would be by trusting in the performance of the markets instead of their performance as investors.

Analysts at BlackRock have shown similar findings. A hypothetical $100,000 S&P index fund investment in 1997 would grow to more than $400,000 by 2017, so long as the investor stayed in the market. Given that this 20-year period includes both the dot com bubble bursting and the 2008 financial crisis, that would mean ignoring the instinct to panic and pull out. Even temporary moments of retreat can have big consequences. BlackRock also looked at the hypothetical performance of a $100,000 investment in the MSCI Asia ex-Japan index. Over a thirty-year period from 1988 to 2017, that $100,000 would have grown to $533,824, if the investor had remained in the index the entire time. If the investor had tried to time the market by moving money in and out, and ended up missing just the top 5 days of performance, the portfolio would be worth $167,754 less than if the investor had stayed in the whole time. If the investor had missed the top 20 days, the portfolio would be worth a massive $369,459 less than it would have otherwise.

Volatility and market downturns can test the resolve of any investor, but it is important that you ignore your emotions and try not to make investment decisions based on the short term. Being a disciplined investor means having a clear sense of your goals and timeframes. It is important to work with an investment professional who can help you keep your financial goals in mind, help you better understand how much risk you are willing to tolerate, and help you develop strategies like diversification and asset allocation so that you can be more confident that your portfolio will be able to weather any downturns and still be positioned to take advantage of the eventual recovery.