Market Madness: Trying to Time Dips and Corrections

With stock indexes swinging wildly and off their recent peaks, investors may be tempted to try their hand at market timing. But, as history has shown, trying to guess the market's next move is a losing game.

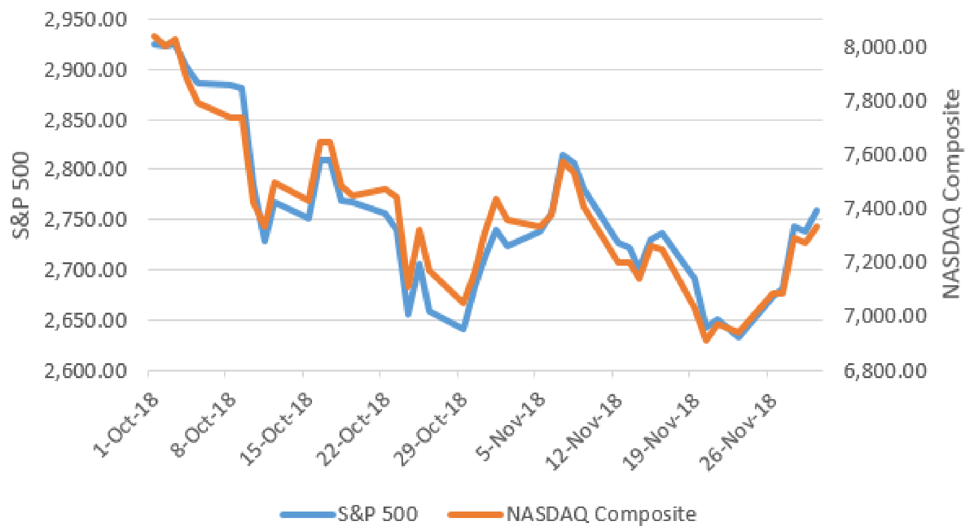
Stock benchmarks dipped into correction territory in November, marking a 10% drop from their recent peaks.

If you haven't looked at your 401(k) or brokerage statement recently, you may want to first sit down, take a deep breath, and stay calm. Anyone with a significant allocation to stocks or stock funds is likely to see a hit to their bottom line balance.

Indeed, stocks have been on a roller coaster ride lately. Since hitting a peak in mid-September, the S&P 500® index has tumbled, dipping briefly into correction territory (down 10% from its peak) on November 23. The tech-heavy NASDAQ Composite index has fared even worse, dropping almost 15% from its August peak by November 20. A late-month rally helped both indexes recover some ground, but left them well off their earlier highs.[1]

Markets Take a Dip

S&P 500 and NASDAQ Composite, October 1 to November 30, 2018[1]



Market analysts attribute the volatility to number of different factors. Growing evidence of a slowdown in the global economy, rising interest rates, an uptick in inflation, a blossoming trade war -- all are fueling fears that stocks may be overvalued. And, as the economic stimulus of the 2017 tax cut fades and the Federal Reserve continues to raise rates, some expect things to get worse. Many also view the plunge as gravity at work. Stocks have seen a sustained run up since early 2016, leaving valuations historically high.

The Futility of Market Timing

The volatility presents a tempting scenario for would-be market timers -- those who try to predict when stock prices will rise and fall and attempt to buy low and sell high. While this may seem to make sense in theory, it's extremely difficult to pull off successfully. Typically, you can't accurately pinpoint a market high or low point until after it has occurred. If you move your money out of stocks during a low period, you might not move your money back in time. By the time you realize stocks are on an upswing, it may be too late to take advantage of gains.

In fact, history has shown that trying to time the market's ups and down is a loser's game. Even the experts, with their analytical prowess and sophisticated computer models, cannot manage to consistently beat the market. A landmark study by CXO Advisory Group tracked more than 4,500 forecasts by 28 self-described market timers, between 2000 and 2012. Only 10 were able to accurately forecast equity returns (as measured by the S&P 500) over 50% of the time, and none were able to predict accurately enough to outperform the market.[2] Nobel Laureate William Sharpe calculated a market timer would have to be correct 74% of the time -- on both the market decline and recovery -- to outperform another investor who just lets their money sit in a passive portfolio of comparable risk.[2]

Consider Time in Market Instead

Clearly, time can be a better ally than timing. Instead of trying to time the market, you may be better off with a well-coordinated investment strategy based on your personal risk tolerance and time frame. While past performance is no guarantee of future results, the stock market has always recovered from every downturn. So think twice before trying to time the market's dips and corrections, and work with your financial advisor to ensure that the investments you select are in keeping with your goals.

[1]Source: Google Finance, based on closing prices of the S&P 500 and NASDAQ Composite indices.
[2]Source: Index Fund Advisors, Inc. (IFA.com), 2014. Based on a study by CXO Advisory, © CXO Advisory Group LLC.