

Why 'timing the market' is a fool's errand



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BY ANNABELLE DICKSON

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It's an age-old question, is it possible for a person to time the share market? All the data seems to be pointing very firmly to no. It's simply too hard to do.

Many investors try to pick the bottom of the share market to take advantage of any following rebound. This approach is referred to as 'market timing' and involves making investment decisions based on short-term market movements.

BEFORE YOU GET STARTED

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In contrast, a buy-and-hold approach involves buying shares and holding them over the long-term, irrespective of market movements. An overwhelming body of research finds that this passive buy-and-hold, long-term approach to owning shares produces better long-term results.

We crunched the numbers using the S&P/ASX 200 benchmark index, and our analysis showed just how big a difference it can make when investors miss out on a handful of the biggest rallies.



	S&P/ASX 200	S&P/ASX 200 (minus top 5 days)	S&P/ASX 200 (minus top 20 days)
1 Year (%)	7.09%	7.09%	7.09%
3 Years (% p.a.)	9.56%	9.56%	9.56%
5 Years (% p.a.)	9.71%	7.01%	3.21%
10 Years (% p.a.)	8.39%	7.05%	5.14%
20 Years (% p.a.)	8.90%	7.62%	4.12%
30 Years (% p.a.)	8.54%	7.49%	5.14%

Source: Bloomberg, Betashares. As at 31 January 2024. Past performance is not indicator of future performance. Top five and top 20 days since over the last 30 years have been removed from the respective data sets. None of these days occurred in the past year so one year returns are unaffected.

This might seem like ‘cherry-picking’, but in reality, if you tried market timing, there’s a good chance you’d miss out on some of the biggest rallies. Humans have a tendency to avoid loss, (called loss-aversion bias) which can cause investors to throw their strategy out the window and sell when markets turn bad. However, this can be precisely the worst time to sell, as the biggest rallies can happen in the middle of major market falls (see table below). And the more of those big rallies that you miss out on, the lower your gains over the long term.

The 20 biggest 1-day rallies have occurred during or soon after a major crash

In contrast, by staying invested in the benchmark share market index, you would automatically capture all market movements, which over time may prove to be advantageous.

ASX

Date	1-day rally	Crash
30/3/2020	7.0%	Covid crash
29/10/1997	6.1%	Asian financial crisis
17/3/2020	5.8%	Covid crash
25/11/2008	5.8%	Global financial crisis
13/10/2008	5.6%	Global financial crisis
25/3/2020	5.5%	Covid crash
3/11/2008	5.1%	Global financial crisis
25/1/2008	5.0%	Global financial crisis
20/8/2007	5.0%	Global financial crisis
22/9/2008	4.6%	Global financial crisis
13/3/2020	4.4%	Covid crash
23/1/2008	4.3%	Global financial crisis
6/4/2020	4.3%	Covid crash
20/10/2008	4.3%	Global financial crisis
28/11/2008	4.3%	Global financial crisis
19/9/2008	4.3%	Global financial crisis
1/10/2008	4.2%	Global financial crisis
24/3/2020	4.2%	Covid crash
8/12/2008	4.1%	Global financial crisis
30/10/2008	4.0%	Global financial crisis

start date 1/6/1992

NASDAQ

Date	1-day rally	Crash
3/1/2001	18.8%	Dot com bubble
13/10/2008	12.6%	Global financial crisis
5/12/2000	11.7%	Dot com bubble
28/10/2008	10.9%	Global financial crisis
5/4/2001	10.8%	Dot com bubble
8/5/2002	10.6%	Dot com bubble
21/10/1987	10.3%	Black Monday ('87 crash)
17/4/2000	10.1%	Dot com bubble
30/5/2000	10.1%	Dot com bubble
13/3/2020	10.1%	Covid crash
29/10/1987	9.7%	Black Monday ('87 crash)
18/4/2001	9.5%	Dot com bubble
22/12/2000	9.5%	Dot com bubble
13/10/2000	9.1%	Dot com bubble
19/10/2000	8.4%	Dot com bubble
25/4/2000	8.0%	Dot com bubble
10/4/2001	7.9%	Dot com bubble
24/3/2020	7.8%	Covid crash
3/10/2001	7.8%	Dot com bubble/Sept 11 attacks
10/11/2022	7.5%	2022 Tech crash

start date 4/2/1985

Source: Bloomberg, Betashares. As at 31 January 2024. Past performance is not indicator of future performance.

Independent research points to the same result

It is not just our research that is coming to this conclusion. A recent paper from JP Morgan, *Is market timing worth it during periods of intense volatility?* revealed that timing the market is almost impossible to achieve given that good and bad trading days fall so closely together.¹

As at the end of 2021, seven of the best days in the US had occurred within two weeks of their corresponding worst day; but often the gap between the best and worst days was much shorter.

For example, March 12, 2020 was the second-worst day of the year in US share markets, yet that was immediately followed by the second-best day of the year.

JP Morgan’s study found that the worst days overwhelmingly occurred before the best days: over the last 20 years, six of the seven best days occurred after the worst day.

The close proximity of the best and worst days makes it virtually impossible to buy shares at the bottom before they climb again as most people are not that quick or lucky.

In other words, it is very unlikely that an investor could be lucky enough to consistently miss the worst days while being invested in the market for the best days.

JP Morgan’s final thought is this: “It is important to remind investors that success is achieved through time in the market, not timing the market. And, to quote Dolly Parton, ‘If you want the rainbow, you gotta put up with the rain.’”

We’d have to agree with that.

The pain of missing out

Separate research from the Schwab Center for Financial Research, *Does Market Timing Work?* found that even badly timed stock market investments were much better than having no share market investments at all.

“Procrastination can be worse than bad timing. Long term, it’s almost always better to invest in stocks—even at the worst time each year—than not to invest at all,” according to their research.”

That’s because investors who procrastinate and do nothing are likely to miss out on the stock market’s potential growth.

“Procrastination can be worse than bad timing. Long term, it’s almost always better to invest in stocks—even at the worst time each year—than not to invest at all,” according to their research.

“Given the difficulty of timing the market, the most realistic strategy for the majority of investors would be to invest in stocks immediately.”

If you don’t have a large single sum to invest or like the discipline of investing small amounts regularly, then dollar-cost averaging can assist in mitigating market timing risk and can help you gradually accumulate wealth.

Similar to a regular savings plan, dollar cost averaging involves investing the same amount of money at set intervals over a long period - whether market prices are up or down.

The key takeaway

It is almost impossible to time the market consistently whether it is over a short term time frame or over the long term.

Instead, investors should consider having a well-diversified portfolio and holding it over the long-term.

ETFs are well-suited to this investment approach by providing a convenient, cost-effective way to get exposure to all the major asset classes. ETFs track benchmark indices for various markets, including Australian and global equities, fixed income, cash and commodities.

You can use ETFs to build the core of your portfolio - investments that will provide your portfolio with a foundation for the long term, through the market’s up and down cycles. For example, the Betashares Australia 200 ETF (ASX: A200) provides exposure to the largest 200 companies on the ASX at an annual management cost of just 0.04% - making it the world’s lowest cost Australian shares ETF*.

So you can sit back and enjoy your investment growing over time, without trying to time the market.

*Source: Bloomberg, based on expense ratios of Australian shares ETF based in Australia or on overseas exchanges as at 20 February 2024. Additional fees and costs, such as transactional and operational costs, may apply. Refer to the Product Disclosure Statement for more information.

BetaShares is a leading Australian fund manager specialising in exchange traded funds (ETFs) and other Funds traded on the Australian Securities Exchange (ASX). Since launching their first ETF more than a decade ago, BetaShares has grown to become one of Australia’s largest managers of ETFs.



How is global growth tracking?

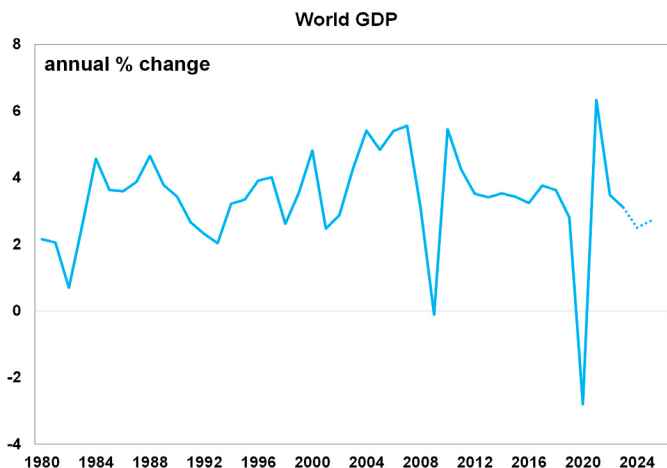
KEY POINTS

- We expect global growth to be ~2.5% in 2024, below the long-run average of ~3% and lower than the IMF’s forecast.
- A global recession is unlikely. However, given that most major central banks have been raising interest rates, the risk of over-tightening is high, reflected in recent poor GDP growth in countries across Europe and Japan.

BY DIANA MOUSINA

Republished from amp.com.au

Global economic growth, as measured by GDP tends to average at 3% over the long run. This year we see global growth running at a sub-average 2.5% (see the chart below) after 3.1% in 2023. Institutions like the IMF are more optimistic, estimating 3.1% for 2024 and 3.2% for 2025.

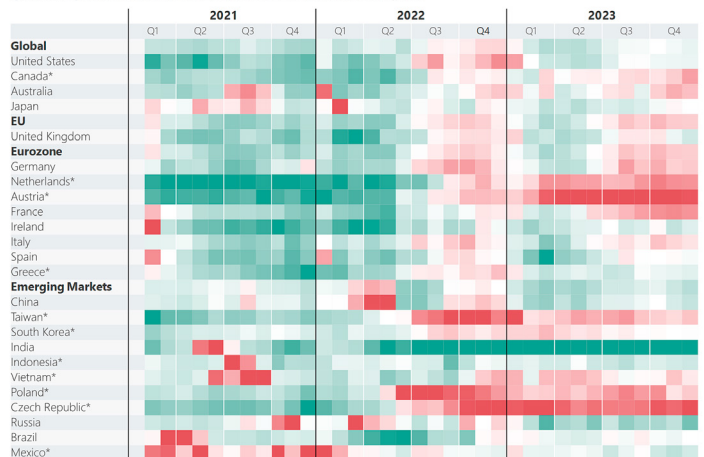


Source: IMF, AMP

The “heatmap” below shows the evolution of economic growth across the largest economies in the world. GDP growth in 2023 was weaker compared to 2021, particularly in Europe and parts of the emerging world.

Green and red lights for global growth

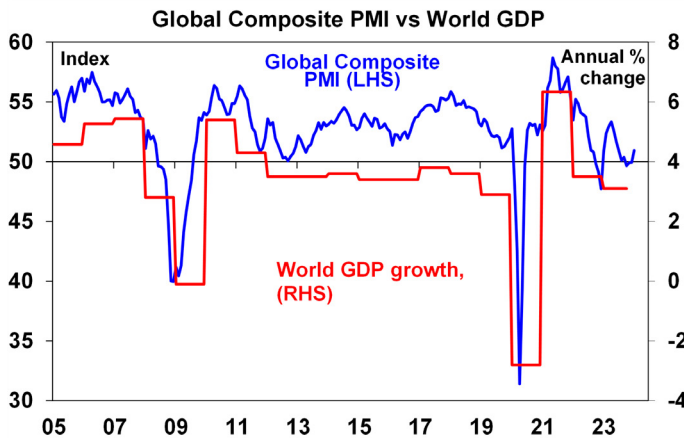
Source: S&P Global (global leading indicators, where available composite PMI otherwise manufacturing PMI*)



Color legend: White = values equal or are slightly above/below 50, Green = values are above 50, Red = values are below 50. A reading above 50 indicates an expansion of the economy in comparison to the previous month and below 50 represents a contraction, while 50 corresponds to no change.

Source: Macrobond, AMP

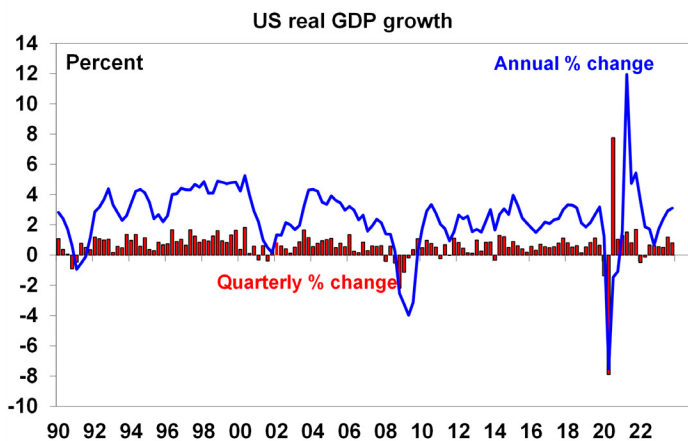
We often reference the Purchasing Managers Indices (or PMIs) as leading indicators of growth across manufacturing and services firms. The composite PMI (with is a weighted average of manufacturing and service conditions) has been trending up again since late 2023 (see the chart below), with better conditions for both manufacturing and service firms, a positive sign for global growth and not in line with a global growth downturn.



Source: Bloomberg, AMP

Will the US remain recession-proof?

The strength in the US economy is often a barometer for the rest of the world through the demand channel, being the largest economy in the world, and the financial market channel, with many major equity, currency and fixed income markets taking their lead from US markets. The strength in the US economy in 2023 despite the tightening to interest rates since early 2022 was surprising. GDP growth in the December quarter of 2023 was at 3.3% annualised and current expectations for the March quarter this year is tracking at 3.4%. Consumer spending has been the strongest component of growth, with positive contributions from government spending and private business investment while net exports and inventories have detracted from growth.

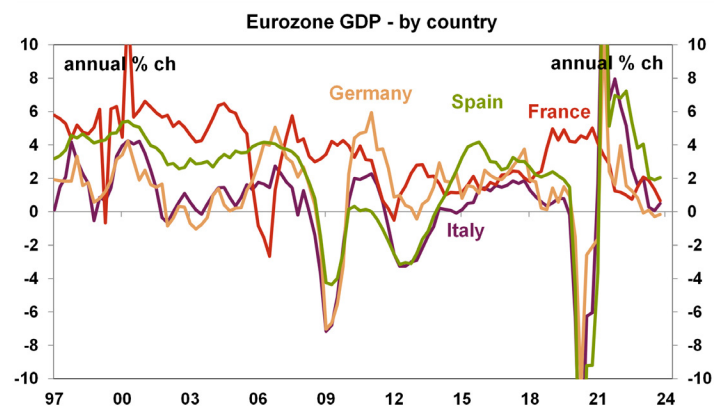


Source: Bloomberg, AMP

Despite this strength, there is still a moderate chance of a US recession in 2024, according to some leading indicators like the inverted yield curve, ISM new orders, some measures of consumer confidence and lending standards. The labour market is weakening, with job advertisements falling and the unemployment rate ticking up (although it is still low compared to history). Inflation has dropped to 3.1% year on year, and we think it will be at 2.5% by December, as wages growth moderates and helps to reduce services inflation which should allow the US Federal Reserve to cut interest rates by mid-2024. We expect GDP growth to slow to 1.4% over the year to December, well below 2023 levels, but not quite consistent with a recession, which is positive for US earnings growth and the sharemarket.

Eurozone economy to struggle without rate cuts

Eurozone GDP growth has barely increased over the past year, with GDP growth ending 2023 at just 0.1% over the year. Weakness is evident across Germany, France and Italy, while Spain is still holding up (see the chart below). Eurozone growth has suffered from the slowing in global manufacturing and lower Chinese imports which has weighed on Eurozone net exports. Inflation has dropped down to 2.8% over the year to January (according to the headline CPI), down from its cyclical high of 10.6% in October 2022. We think the poor growth environment and progress in inflation will see the European Central Bank start to cut interest rates around mid-year, or slightly earlier. An improvement in global manufacturing conditions in 2024 (according to the PMI) and rate cuts should see Eurozone growth at 0.9% in 2024, an improvement from last year.

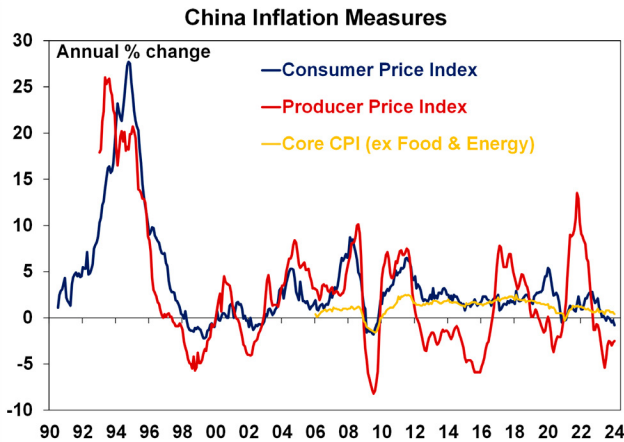


Source: Reuters, AMP

China needs more stimulus... but it may not get it

The Chinese economy is facing numerous concurrent growth headwinds. The lengthy COVID-19 lockdowns had a big negative impact on consumer spending (particularly for services) which is yet to fully recover, the property market is dealing with excess housing stock, overinvestment and

problems with developers, an aging population has reduced workforce productivity and participation and Chinese shares are down more than 40% since their 2021 highs which is negative for consumer confidence as many Chinese people use the sharemarket as an investment (in the absence of a pension scheme). Reflecting soft growth conditions, China's consumer prices are in deflation at -0.8% over the year to January (see the chart below) which weighs on corporate earnings, household wages and depresses sentiment.



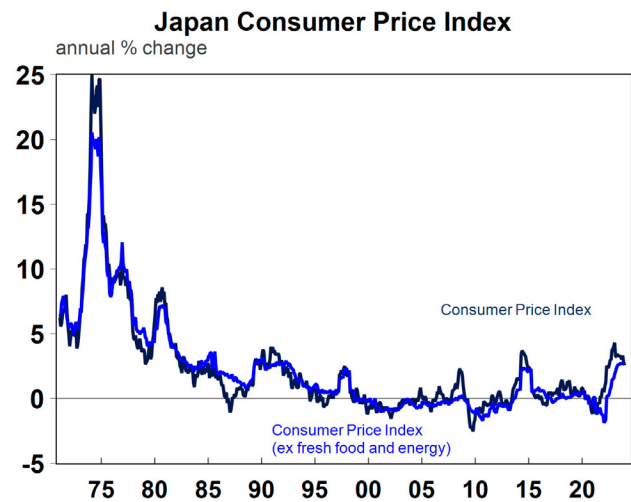
Source: Bloomberg, AMP

Policymakers have focused stimulus measures on reducing borrowing costs, increasing corporate bond issuance and targeted infrastructure programs. But, without further monetary and fiscal easing (particularly for households to increase confidence and encourage spending rather than saving), Chinese growth will remain subdued. We expect GDP growth of around 4.6% in 2024 and 3% next decade. This is a much lower rate than the world has been used to given that China was growing at ~10% between 2006-10, although given the Chinese economy is now more than twice the size it was back then, there is still a positive and sizeable contribution to global growth and demand for commodities (which is important for Australia).

When will Japan start to tighten monetary policy?

The Bank of Japan is the last major central bank that has not tightened monetary policy in the post-COVID period. The current policy rate is at 0.1%, and interest rates have ranged between -0.1% to 0.5% since the late 1990s. Low interest rates relative to global peers has seen the Japanese yen depreciate by over 30% since 2022. However, the pressure is building on the Bank of Japan to start tightening monetary policy. The Bank of Japan already loosened its yield curve control target on bond yields and the next step will be to fully remove yield control before eventually increasing interest rates. Headline consumer price inflation is running at 2.6% over the year to December 2023 and

2.8% for core inflation (which excludes food and energy). However, Japan's historical difficulty in lifting and sustaining inflation and inflation expectations and recent poor GDP growth outcomes (which have seen GDP growth fall over the September and December quarters in 2023 meaning a technical recession) means the Bank of Japan will tread carefully in hiking rates and only 10-20 basis points of rate hikes likely this year.



Source: Macrobond, AMP

Implications for investors

2024 is likely to be a year of slower GDP growth around the world, but a global recession is unlikely. This is good news for global earnings and sharemarkets, as a result and we expect global equities to have positive returns in 2024 around 7%. A further decline in global inflation will allow numerous global central banks to start cutting interest rates later this year, which will make way for stronger global growth in 2025.

Geopolitics always matter for investors, but in 2024 this could matter more as around 50% of the global population will have an election. Elections cause uncertainty and potentially change which is likely to see additional volatility in share markets. The US Presidential election in November is a major risk event for both the US and the world, especially because of the potential impacts of the election on US fiscal policy (and how that translates to bond yields) and US trade policy (especially as it relates to China). Geopolitical issues often also cause disruptions to commodity prices and global transport costs, which impact inflation. A second-round lift in inflation or persistent elevated inflation is also a risk for the developed economies in 2024 which would delay the start of central bank interest rate cuts.

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Which type of investor are you?

BY JOE WIGGINS

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It is so tempting to get lost in the noise and intrigue of financial markets that we can easily forget what type of investor we are. Although the investing community can at times appear something of an amorphous blob attached to the latest in-vogue topic; groups of participants are engaged in wildly different activities that - at anything but a cursory level - are barely related. To have any chance of success it is critical to understand the realities of our own approach and avoid playing somebody else's game.

In broad terms, I think there are four investor types:

Trader

A trader operates with ultra-short time horizons (intra-day to weeks) and is typically engaged in the prediction of price movements based on historic patterns or the expected market reactions to certain events (if X happens, prices will do Y). Asset class valuations and fundamentals are largely irrelevant, and the focus is on forecasting the response function of other investors.

This is staggeringly difficult to do consistently well, which is why profits often seem to accrue to the people who teach trading to others rather than do it themselves.

Price-based investor

Almost certainly the most common active investment approach. Price-based investors have short time horizons (ranging from three months to perhaps three years) and tend to engage in one of two related activities:

1. Predicting future market / macro factors and how other investors will respond to them. "We believe that the Fed will be more accommodative than the market expects, which will support US equities."
- or
2. Predicting how other investors will react to realised market / macro factors. "The Fed is far more dovish than the market expected, therefore we have increased our exposure to US equities."

The common factor in both of these closely related methods is that investors are guessing how other investors will behave. This is similar to trading, but the horizons are extended (though still what I would class as short-term). In essence it is an attempt to capture anticipated price trends.

Valuations and fundamentals matter somewhat for this group, but only insofar as they are useful for understanding the positioning and future decisions of other people like them.

This is probably the most comfortable style of investing from a behavioural perspective as it caters to plenty of our

“ These categories are not quite as discrete as I have made out, but the overall point holds. Defining our own approach and understanding its realities and limitations is absolutely critical for any investor. ”

biases - our desire to be active, to be part of the herd, to tell stories. For similar reasons, it is also likely to prove the most prudent survival strategy for professional investors.

The problem is that it is incredibly challenging to get these types of calls right (or even more right than not).

Valuation-based investor

This type of investor is focused on the fundamental attributes of an asset and will look to make some assessment of expected return or fair value based on analysis of starting price and future cash flows. Given that price fluctuations dominate short-term asset class performance, a long view is essential.

It is important not to confuse a valuation-based approach with value investing, which is only a subset of it. Valuation-based investors are seeking to identify asset mispricings - these might occur because the level of growth is underappreciated, or high returns on capital will persist. The key distinction is that the focus is on the returns produced by the asset rather than how other investors might trade it.

Given that market movements over short and medium horizons often bear little relationship with the fundamental features of an asset class, a valuation-led approach is undoubtedly the most behaviourally taxing. This group will inevitably spend a great deal of time appearing out of touch and idiotic, even if they are right, and they might end up waiting years for validation that never arrives (taking a valuation-led approach doesn't mean that you will necessarily be correct in the end).

Relative to a price-based investor they are more likely to be successful in their investment decision making, but also more likely to lose their job.

Passive investor

Although there is no purely passive portfolio, this group seeks to invest in a fashion that can be considered a broadly neutral representation of the relevant asset class opportunity set (by size). While passive investors are inherently agnostic on valuation, they do care about the fundamental

features of the assets in which they invest, but specifically in regard to the ultra-long run, or structural, expected risk and return.

A passive investor may not believe that markets are efficiently priced, but simply there is no reasonable and consistent way of capturing any inefficiencies (certainly relative to the effort or behavioural stress required), particularly after costs.

Although a long-term, passive approach appears simple it is not without behavioural challenges - doing nothing is tough and rarely lucrative. There will also be incessant speculation around how some profound change in asset class behaviour will soon render a passive approach defunct.

But perhaps a more credible problem is that a purely passive style requires investors to be ambivalent about extreme asset class overvaluation - passive investors are fully / increasingly exposed to equities trading at 100x PE or bonds yielding zero - even if the evidence suggests this will lead to derisory future returns. It is reasonable to suggest that this is a known cost and one which still leaves it superior to other strategies. It should not, however, be ignored.

Which one are you?

These categories are not quite as discrete as I have made out, but the overall point holds. Defining our own approach and understanding its realities and limitations is absolutely critical for any investor. This requires setting realistic expectations, knowing the information that matters and what should be ignored, and preparing for the specific behavioural issues we will encounter. Failure to do this will mean we will inevitably become part of that amorphous blob.

All investors should be asking who they are and what it means.

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Q&A: Ask a Question

Question 1

I heard that investing in funeral bonds can potentially increase your Age Pension payments. How does it work?

Investing in a funeral bond can potentially increase your Centrelink entitlements by reducing your assessable assets for means testing purposes. Centrelink assesses an individual's assets when determining eligibility for government benefits such as the Age Pension or aged care subsidies. Funds held in a funeral bond up to a limit are generally exempt from means testing, meaning they are not counted as assessable assets.

By investing in a funeral bond and allocating these funds towards funeral expenses, you can effectively reduce the total value of your assessable assets. This reduction can lead to an increase in your Centrelink entitlements, as you may fall within the asset thresholds required to qualify for higher pension payments or aged care subsidies.

It's important to note that the rules and exemptions regarding Centrelink entitlements can vary, and eligibility criteria may change over time. Therefore, if you are considering investing in a funeral bond for the purpose of increasing Centrelink entitlements, you should seek advice from your financial adviser to understand how it may impact your specific circumstances.

Question 2

I heard from a friend of mine that my insurance premiums could have a stepped or level premium structure. What is the difference between the two?

Stepped and level premiums are two types of premium structures for insurance policies, with differing approaches

to how premiums are calculated and changed over time. Stepped premiums start lower but increase gradually as you age, as well as with other factors. This structure makes stepped premiums initially more affordable, but they tend to become more expensive over time. In contrast, level premiums do not increase with your age each year but can increase due to other factors, generally remaining more constant throughout the life of the policy, providing predictability and stability in premium payments. Level premiums are more expensive than stepped premiums initially, however, they have the potential to become more cost-effective over time. You should see your financial adviser to determine which type of premium structure is most suitable for your individual circumstance.

Question 3

I hear that everyone is investing in this thing called ETFs. What is an ETF and what are the benefits of investing in ETFs?

An Exchange-Traded Fund (ETF) is a diversified investment fund traded on stock exchanges. It can offer you exposure to a wide range of assets within a single investment vehicle. ETFs can track the performance of specific indexes or sectors and provide diversification, helping spread risk across different assets. With lower management fees compared to actively managed funds, ETFs offer cost-effective investment options while providing transparency into their holdings and liquidity through trading on stock exchanges. If you are interested in investing in ETFs, you should consult your financial adviser who can ensure that you are invested according to your needs and objectives.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to centraladvice@wtfglimited.com.



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