



Hubris and the Market: Why Timing Doesn't Work

A study by Morningstar recently indicated that 'Joe Mainstreet' only received an annualized return of 1.68% on his investments. This is a paltry number, especially compared with the average fund's return of 3.18%. The study concluded that investors experienced this loss mostly because of their efforts to utilize 'market timing.' We define market timing as the strategy of making buy or sell decisions of financial assets by attempting to predict future market price movements. For market timing to work, someone must have the hubris to believe they can predict the future.

Bad market timing can ruin everything from a good fund pick to a long-term position. Past performance can also lead investors to jump in after all of the major gains have been achieved. For example, a hypothetical fund with \$10 million in capital produces a 20% return in its first year. Investors see these returns and decide to jump on board. The fund grows to \$100 million in its second year but only returns 2%. It remains true that the fund has an annualized 10.6% in its two-year period, but the majority of investors, who jumped in after the first year, only receive an annualized gain of 1.83%. Chasing the market just doesn't work.

Those who study investor behavior might interpret the previous example in a different way. They invest in 'all star' funds because of greed and liquidate their long term positions because they fear the falling market. In effect, they buy high and sell low. We feel this behavior is diametrically opposite to what investors should be doing.

The lesson here is this: your allocation of stocks and bonds should be based on your personal circumstances and risk tolerance. Before you make a big investment decision, we encourage you to take time to evaluate your motivations for doing so and to get in touch with your Relationship Manager to investigate all investment avenues available to you.

Source: 'Investors Lose Big With Market Timing.' *Kiplinger.com*. July 19, 2010.