

Understanding market timing

INVESTOR GUIDE

THE RISKS OF MARKET TIMING

Many people believe investing is about ‘timing the market’ – getting in before prices rise, enjoying the rise up and then getting out before prices fall. Anticipating these market movements can be extremely difficult because no two market cycles are the same.

Investors’ emotions make successful market timing even harder which makes sticking to your plan even more important. While logic suggests the best time to buy is when asset prices are cheap or falling, many investors tend to buy when prices are rising and sell when they are falling. Also common is selling too early when prices still have more to run. The emotions of fear and greed can lead us to buy and sell at exactly the wrong times.

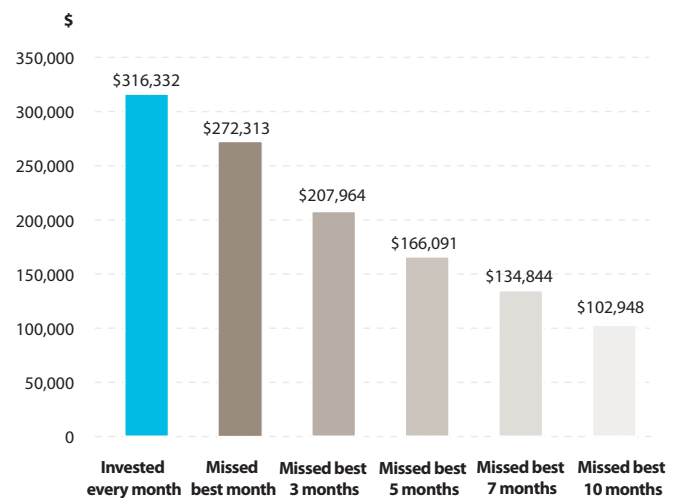
A lot of long-term research suggests that market timing is difficult, even for professionals. It’s not just that expert advice helps you pick better investments, it’s that it helps you stick to a strategy. As an investor, you should allow time for the rises and falls of the market to take their course. The main message from investment experts is that it is better to buy and hold rather than trying to ‘time the market’. As the cliché goes, “it’s time; not timing that counts.”

The time difference

The graph on the right shows the result of investing \$10,000 in the Australian sharemarket in February 1980 and pursuing a “buy and hold” strategy. This resulted in the original investment being worth \$316,332 on 31 July 2007. The graph also shows the effects on the investment of missing the best performing months (that is, months where investment returns were the highest) – the difference is quite substantial. Calculations indicate that an investor who incorrectly attempted to ‘time the market’ and missed the single best month over a 27 year period ended up with \$272,313, almost 14% less than the investor who pursued the buy and hold strategy.

Investors who sat on the sidelines and missed the best 10 months over a 27 year period finished with just \$102,948, 67% less than the patient “buy and hold” investor’s end value. As you can see, disciplined investing would have been a better investment strategy.

Effect of missing best month(s)



Graph prepared by Russell Investment Management Ltd from data sourced from ASX. ASX All Ords Accum Index in AUD 29/02/80 to 31/07/07.

Market timing is difficult, even for professionals.

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