



Financial Fables

Market Timing: Irresistible But Ineffective

On July 18, 2006 the Dow Jones Industrial Average rose 51.87 points to close at 10799.23, within a whisker of its 10799.84 closing price on June 4, 1999 over seven years ago. After lengthy periods of such trend-less stock market results, some investors find the temptation to enhance returns through market-timing strategies irresistible.

A number of timing-oriented newsletters offer advice on when to buy and sell. In a recent article focusing on the appeal of market timing, investment newsletter tracker Mark Hulbert cites one popular newsletter with "one of the best market-timing performances of any that the Hulbert Financial Digest has tracked since 1980." But Hulbert points out that a strategy of switching between money market funds and stocks based on this newsletter's timing signals underperformed a buy-and-hold strategy by 1% per year over the past 15 years. The publisher of the newsletter, according to Hulbert, continues to tinker with his timing models in an effort to improve results.

Hulbert does not dismiss the possibility of achieving success with timing-based strategies, but concludes "it should be sobering to us all that even one of the most experienced market-timers has had such difficulty finding a successful system."

It never ceases to amaze me that study after study shows that it is virtually impossible to beat the market and most attempts to beat the market (usually stock picking and market-timing) end up underperforming it because of increased costs and volatility. Most of these active managers who have beaten the market can be explained statistically as chance. There are a very few that appear to have beaten the market based on skill instead of chance. Unfortunately there is no way to identify these individuals in advance. That is why we believe that the best strategy is a thoughtfully designed, diversified strategy of "passive" asset class funds. It's not easy to structure and maintain such a strategy. It requires research and discipline to stay the course. But it's much easier than predicting which active managers will randomly beat this approach.