WT WEALTHMANAGEMENT FEB. 2014

DOES MARKET TIMING WORK?

Imagine for a moment that you've just received a year-end bonus or income tax refund. You're not sure whether to invest now or wait. After all, the market recently hit an all-time high. Now imagine that you face this kind of decision every year—sometimes in up markets, other times in downturns. Is there a good rule of thumb to follow?
Research shows that the cost of waiting for the perfect moment to invest exceeds the benefit of even perfectly timing the markets. Timing the market perfectly is, well, about as likely as winning the lottery, the best strategy for most of us mere mortal investors is not to try to market-time at all.
Instead, make a plan and invest as soon as possible.

FIVE INVESTING STYLES

Don't take my word for it. Consider the vast available research on the performance of five hypothetical long-term investors following very different investment strategies. This study has appeared and reappeared dozens of times over the last 20 years. Usually as the market has reached all-time highs and everyone is waiting for the "correction". Let's say each investor received $2,000 at the beginning of every year for the 20 years ending in 2012 and left the money in the market, as represented by the S&P 500 Index. Let's review how they would have fared:

1. "Paul Perfect" was a perfect market timer. He had incredible skill (or luck) and was able to place his $2,000 into the market every year at the lowest monthly close. For example, Paul had $2,000 to invest at the start of 1993. Rather than putting it immediately into the market, he waited and invested after month-end January 1993—that year's monthly low point for the S&P 500. At the beginning of 1994, Paul received another $2,000. He waited and invested the money after March 1994, the monthly low point for the market for that year. He continued to time his investments perfectly every year through 2012.

2. "Anna Action" took a simple, consistent approach: Each year, once she received her cash, she invested her $2,000 in the market at the earliest possible moment.

3. "Michael Monthly" divided his annual $2,000 allotment into 12 equal portions, which he invested at the beginning of each month. This strategy is known as dollar cost averaging. You may already be doing this through regular investments in your 401(k) plan or an Automatic Investment Plan, which allows you to deposit money into mutual funds on a pre-arranged timetable.

4. "Rosemary Rotten" had incredibly poor timing—or perhaps terribly bad luck. She invested her $2,000 each year at the market's peak, the exact opposite of the old adage "buy low." Looking back, Rosemary invested her first $2,000 at the end of December 1993—that year's monthly high point for the S&P 500. She received her second $2,000 at the beginning of 1994 and invested it at the end of August 1994, the peak for that year.

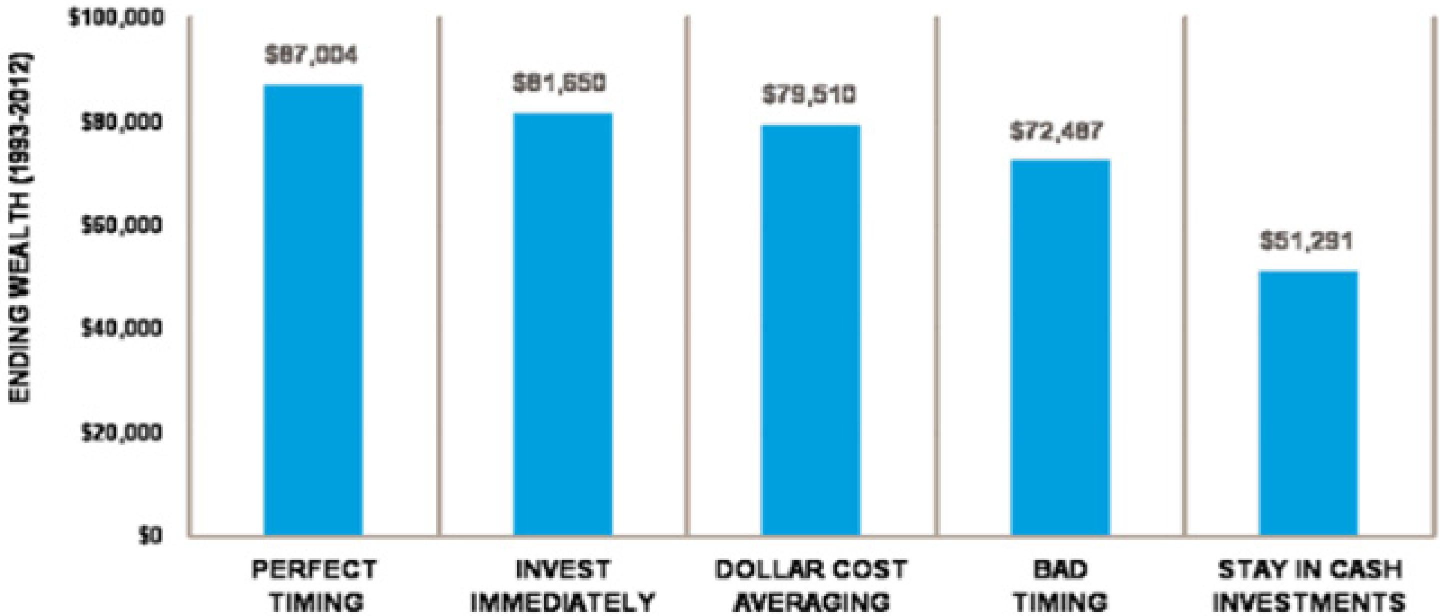
5. "Lou Linger" left his money in cash investments (using Treasury bills in this example) every year and never got around to investing in stocks at all. He was always convinced that lower stock prices—and better opportunities to invest his money were just around the corner.

THE RESULTS ARE IN: INVESTING IMMEDIATELY PAID OFF

For the winner, look at the graph, which shows how much hypothetical wealth each of the five investors had accumulated at the end of the 20 years (1993–2012). Actually, we looked at 68 separate 20-year periods in all, finding similar results across almost all time periods.

Naturally, the best results belonged to Paul, who waited and timed his annual investment perfectly: He accumulated $87,004. But the study's most stunning findings concern Anna, who came in second with $81,650—only $5,354 less than Paul Perfect. This relatively small difference is especially surprising considering that Anna had simply put her money to work as soon as she received it each year—without any attempt at market timing.

Michael's dollar-cost-averaging approach delivered solid returns, earning him third place with $79,510 at the end of 20 years. No surprise as countless studies have affirmed and reaffirmed the benefits of having a systematic investment plan.



Hypothetical $2,000 annual investments in S&P 500 Index. The individual who never bought stocks in the example invested in the Ibbotson U.S. 30-day Treasury Bill Index. Past performance is no guarantee of future results. Indexes are unmanaged, do not incur fees or expenses and cannot be invested in directly. The examples are hypothetical and provided for illustrative purposes only. They are not intended to represent a specific investment product and investors may not achieve similar results. Dividends and interest are assumed to have been reinvested, and the examples do not reflect the effects of taxes, expenses, or fees. Had fees, expenses or taxes been considered, returns would have been substantially lower.

Rosemary Rotten's results also proved surprisingly encouraging. While her poor timing left her $9,163 short of Ashley, who didn't try timing investments at all, Rosie still earned nearly 50% more than what she would have if she hadn't invested in the market at all.

....and what of Lou Linger? The procrastinator who kept waiting for a better opportunity to buy stocks and then didn't buy at all? He fared worst of all, with only $51,291. His biggest worry had been investing at a market high. Ironically, had he done that each year, he would have still earned nearly 50% more over the 20-year period.

WHAT THIS MIGHT MEAN FOR YOU

If you make an annual investment, such as a contribution to an IRA or to a child's 529 plan, and you're not sure whether to invest in January of each year, wait for a "better" time or dribble your investment out evenly over the year, know the facts. The best course of action for most of us is to create an appropriate plan and take action on that plan as soon as possible. It's nearly impossible to accurately identify market bottoms on a regular basis. So, realistically, the best action that a long-term investor can take, based on our study, is to invest at the first possible moment, regardless of the current level of the stock market.

If you're tempted to try to wait for the best time to invest in the stock market, countless studies have suggested that the benefits of doing this are not all that impressive—even for perfect timers. Remember, over 20 years, Paul Perfect amassed around $5,000 more than the investor who put her cash to work right away.

Even badly timed stock market investments were much better than no stock market investments at all. This study suggests that investors who procrastinate are likely to miss out on the stock market's potential growth. By perpetually waiting for the "right time," Lou sacrificed $21,196 compared to even the worst market timer, who invested in the market at each year's high.

CONSIDER DOLLAR COST AVERAGING AS A COMPROMISE

If you don't have the opportunity, or stomach, to invest your lump sum all at once, consider investing smaller amounts more frequently. As long as you stick with it, dollar cost averaging offers several benefits:

- **Procrastination Prevention:** Some of us just have a hard time getting started. We know we should be investing, but we never quite get around to it. Much like a regular 401(k) payroll deduction, dollar cost averaging helps you force yourself to invest consistently.

- **Regret Minimization:** Even the most even-tempered stock trader feels at least a tinge of regret when an investment proves to be poorly timed. Worse, such regret may cause you to disrupt your investment strategy in an attempt to make up for your setback. Dollar cost averaging can help minimize this regret because you make multiple investments, none of them particularly large.

- **Timing Avoidance:** Dollar cost averaging ensures that you will participate in the stock market regardless of current conditions. While this will not guarantee a profit or protect against a loss in a declining market, it will eliminate the temptation to try market-timing strategies that rarely succeed.

As you strive to reach your financial goals, keep these research findings in mind. It may be tempting to try to wait for the "best time" to invest—especially in a volatile market environment. But before you do, remember the high cost of waiting. Even the worst possible market timers in our studies would have beat not investing in the stock market at all.

IN CONCLUSION

Given the difficulty of timing the market, the most realistic strategy for the majority of investors would be to invest in stocks immediately.
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.
Dollar cost averaging is a good plan if you're prone to regret after a large investment has a short-term drop, or if you like the discipline of investing small amounts as you earn them.

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