Investing for the Long Term

Time in the market is more important than timing the market.

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Despite the plunge the market took in early February, most US stock indices remain at all-time highs. The question is: What does that mean for one's investments and wealth.

Noise About Market Highs and Lows Drives Emotional Reactions

Market highs and lows tend to make investors nervous because as the media pays more attention to the markets, there is more for investors to react to as well. Noise about market highs drives greed; noise about market lows or drops drives fear. These are strong emotions that can make investors believe they need to act.

Should one liquidate portfolios to avoid a potential "imminent" economic collapse? Do markets always fall after reaching all-time highs? Paying attention only to the financial or mainstream media, can make an investor believe he or she must do something.

Regrettably, there is no crystal ball that foretells when the markets will shift. Unless someone is intimately familiar with your portfolio, investments, and financial goals, his or her advice about when to jump out of or back into the market will not be helpful. Time in the market following a consistent plan of action is far more important than trying to time decisions to match market highs and lows.

Markets are usually, but not always, efficient. The "Oracle of Omaha," Warren Buffett, puts it well when he refers to the "manic-depressive nature of Mr. Market." Despite all the information and data that investors have at their fingertips, irrational greed and fear occasionally drive the market for financial assets.

Weighing the Decision to Cash Out

Should one cash out now while the market is high? Stock markets may continue to move higher and extend gains. When investors decide to move their portfolios to cash, they must be prepared to sit and watch on the sidelines as the market potentially continues to reach new highs.

Even if an investor finds it acceptable to watch the market rise after having left it, the larger issue with transitioning a portfolio to cash is that the investor must make correct predictions twice: when to leave the market, hopefully at the high point, and also when to make the call to reenter the market, hopefully at the low point. In the history of the financial markets, no one has been able to do this with any consistency.

It is also important to consider that cash sitting idle in bank accounts will earn minimal interest. It can even be argued that in the current market, cash loses value because of inflation. For example, if the inflation is at 2%, and cash is earning interest of only 0.5%, the real rate of return is negative.

"Forgoing returns in the interest of safety simply won't deliver the returns you need to achieve your long-term goals," says Rob Kapito, President and Director of Blackrock. "In fact, it would take a US investor 35 years to double his or her money in cash, assuming a long-term expected return of 2%."

Holding cash in the bank also presents a psychological challenge: once the portfolio has been removed from the stock market and stocks begin to fall, there will always be reasons to convince an investor into staying out. For example, there was no clear signal in March 2009 when the markets reached the low point of the financial crisis. In colloquial terms, there was no sign telling everyone it was safe to get back in the water.

The Case for Staying the Course

Because no one can consistently call tops and bottoms, it is wise to have an investment process in place that provides some level of comfort across many market scenarios. This will help fight the urge to do something in reaction to the emotions caused by media noise because a clear guide for long-term stability and growth is already in place. .

Ben Carlson recently explained: "It's about having the ability to get over the fear of allowing market forces to stop you from implementing an investment plan. Whatever you choose to do—dollar cost average over time, wait for a market correction, put it all back in at once, or hire a professional—try to have a plan of attack that you can follow. It's no good to create a plan that you have no chance of actually seeing through because you become paralyzed by fear or greed."

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Stock prices have historically risen on average over time. All-time highs are challenged decade after decade. "That is as true today as it was on September 3, 1929, January 11, 1973, January 14, 2000, and October 9, 2007," Charlie Bilello explains. "Unfortunately, no one rang a bell at these all-time high tops, alerting you that there would be no new highs for years to come. Unless this bull market goes on forever, the same will be true today. There will be another large correction. And it will start with an all-time high that looks and feels innocuous. No bell will be rung."

We are not confident in anyone's ability, including our own, to consistently assess short-term psychological influences. Wise investors know we cannot time the markets, so we don't try. We are confident though, that over longer periods, valuations and fundamentals converge. We recommend that investors stay their course and stick to their plans. ■

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