Can you time the market and win?

Following a year like 2014, during which the U.S. market appreciably outperformed its global peers, it is not surprising that investors might question whether they could have anticipated and then facilitated the investments that would have perfectly captured the disparity between markets. These investors may also have expected investment professionals, such as investment advisors or consultants, to have been able to make the tactical shifts a portfolio would have required to accurately reflect and profit from the market volatility; moving in and out of different markets within a very short-term timeframe. Is this a realistic expectation? Is it possible to forecast in the very short-term and then invest with 100% certainty? Of course a market professional may see warning signs that would lead him/her to adjust an asset class allocation or specific investment, but to be able to demonstrate exact market timing on a consistent basis is a science the industry has not yet mastered and quite frankly, is not what a long-term investor should focus on.

Let's look at what attempting to correctly understand and time a market would produce. Obviously, to be invested during the highest performing days and then having the wherewithal to avoid days during which the market sold-off would pay off handsomely. According to table 1, if you had missed the best 5 trading days in the S&P 500 over the last 21 years, your annualized return would have dropped from 9.42% to 7.30%. If you had missed the best 10 days, your return would have decreased to 5.86%, and after missing the best 40 days, over 21 years, the return would have become negative. Put another way, in order to have captured these gains, an investor would have had to know to be invested on these exact days, which totals less than 1% of the 21 years observed (40 days/5288 days). This would have required an investor's market timing skills to be acute and for his/her response time to be precise.

Table 1

The Problems with Market Timing: Missing the Best Days
21 Years (1/3/1994 - 12/31/2014)

$10,000 Invested in the S&P 500 Index	S&P 500 Annualized Return	Value of $10,000 at the end of the Period	Gain/Loss	Impact of Missing Days
All 5288 Trading Days	9.42%	$ 72,098.61	$ 62,098.61	
Less the 5 Days with the Biggest Gains	7.30%	$ 47,829.69	$ 37,829.69	-39.08%
Less the 10 Days with the Biggest Gains	5.86%	$ 35,981.72	$ 25,981.72	-58.16%
Less the 20 Days with the Biggest Gains	3.50%	$ 23,491.90	$ 13,491.90	-78.27%
Less the 40 Days with the Biggest Gains	-0.37%	$ 10,960.28	$ 960.28	-98.45%

Source: Lynx Investment Advisory

On the other side, it goes without saying, if you had missed the worst days in the market, your return would have been considerably stronger. According to table 2, by avoiding the worst 5 days in the market, the return would have increased from 9.42% to 11.69%, at 10 days performance increased to 13.48% and to have eliminated the worst 40 days from performance,

would have generated a 21.09%, annualized return. Clearly these results make the idea of trying to time the market tempting, assuming you are able to get it right.

Table 2

The Problems with Market Timing: Missing the Worst Days
21 Years (1/3/1994 - 12/31/2014)

$10,000 Invested in the S&P 500 Index	S&P 500 Annualized Return	Value of $10,000 at the end of the Period	Gain/Loss	Impact of Missing Days
All 5288 Trading Days	9.42%	$ 72,098.61	$ 62,098.61	
Less the 5 Days with the Biggest Losses	11.69%	$ 110,873.85	$ 100,873.85	62.44%
Less the 10 Days with the Biggest Losses	13.48%	$ 154,900.23	$ 144,900.23	133.34%
Less the 20 Days with the Biggest Losses	16.37%	$ 247,511.00	$ 237,511.00	282.47%
Less the 40 Days with the Biggest Losses	21.09%	$ 548,507.02	$ 538,507.02	767.18%

Source: Lynx Investment Advisory

This argument holds true for international markets as well. According to EAFE index date (table 3), if an investor had missed the 5 best days, his annualized return would have dropped from 5.47% to 3.66%, while omitting the 10 best days pulled the annualized return down to 2.34%. Like the U.S. chart (chart 4), without the 5 worst trading days the return increases to 7.39% and continues up with the elimination of additional negative daily results.

Table 3

The Problems with Market Timing: Missing the Best Days
21 Years (1/3/1994 - 12/31/2014)

$10,000 Invested in the MSCI EAFA Index	MSCI EAFE Annualized Return	Value of $10,000 at the end of the Period	Gain/Loss	Impact of Missing Days
All 5476 Trading Days	5.47%	$ 30,621.62	$ 20,621.62	
Less the 5 Days with the Biggest Gains	3.66%	$ 21,259.49	$ 11,259.49	-45.40%
Less the 10 Days with the Biggest Gains	2.34%	$ 16,240.74	$ 6,240.74	-69.74%
Less the 20 Days with the Biggest Gains	0.31%	$ 10,665.03	$ 665.03	-96.78%
Less the 40 Days with the Biggest Gains	-2.70%	$ 5,630.50	$ (4,369.50)	-121.19%

Source: Lynx Investment Advisory

Table 4

The Problems with Market Timing: Missing the Worst Days
21 Years (1/3/1994 - 12/31/2014)

$10,000 Invested in the MSCI EAFE Index	MSCI EAFE Annualized Return	Value of $10,000 at the end of the Period	Gain/Loss	Impact of Missing Days
All 5476 Trading Days	5.47%	$ 30,621.62	$ 20,621.62	
Less the 5 Days with the Biggest Losses	7.39%	$ 44,708.83	$ 34,708.83	68.31%
Less the 10 Days with the Biggest Losses	8.86%	$ 59,482.29	$ 49,482.29	139.95%
Less the 20 Days with the Biggest Losses	11.13%	$ 91,654.01	$ 81,654.01	295.96%
Less the 40 Days with the Biggest Losses	15.29%	$ 198,265.70	$ 188,265.70	0.00%

Source: Lynx Investment Advisory

The above charts suggest that timing the equity markets is not easy, but what about in the currency markets? Again we run into a similar scenario, according to the below chart, though the U.S. dollar, as represented against the DXY basket of currencies from December 2004 through December 2014, exhibits extreme volatility, trying to capture its highs and avoid its lows is highly improbable. Additionally, it is important to note, according to this chart, currencies return to their original values over time.

Table 5

In conclusion, historical data suggests that trying to time the markets, while periodically may appear relatively obvious and straightforward to some, is ultimately a futile game. In order to achieve the most attractive long-term results, given specific risk guidelines, an investor is best served by focusing on quality businesses, trading at levels not representative of their intrinsic valuations. We believe, while making occasional and logical adjustments to specific investments and portfolios based on valuations is a worthwhile practice meant to benefit an investor's portfolio, in general, taking a long-term investment approach will prove to be most advantageous.