Investors Must Refrain From Market Timing to Avoid Pitfalls

- **Ellen Chang** Dec 18, 2014 12:00 PM EST

NEW YORK (MainStreet) — That the market has reached all-time highs recently does not mean that investors should brace themselves for a correction in the short term.

Long-term investors should refrain from trying to time the market since record market highs can often lead to false patterning, said Mark Matson, CEO of Matson Money, a Cincinnati investment manager with $5.9 billion in assets.

“There is zero correlation relative to where the market will be three months from now and it being at an all-time high,” he said.

Record highs in the market do not mean a bubble is on the horizon, Matson said.

“If investors are waiting for a clear sign that the market can only go up before they get in, they are going to be waiting for a very long time,” he said.

Investors should avoid rebalancing their retirement portfolios often because the returns after stocks have hit an all-time high is nearly equal. The monthly data of the market since 1926 shows that 286 out of 1,006 months hit an all-time high. The subsequent five year return following a market high is 9.11% annualized compared to all other months at 10.11% annualized.

“The return is roughly the same, so investors should allocate to equities for the long-term regardless of whether the market is at an all-time high or not,” Matson said. “Humans are extraordinarily bad about perceiving patterns when they don’t actually exist because we want to see them.”

A “huge” false patterning bias also occurs when active managers beat the market for any time period, he said.

“They are the darlings of the moment and investors tend to flock to them, but their ability to beat the market in the past has zero correlation with their ability to do so in the future,” Matson said.

Believing that a previous return or pattern can predict future earnings is a fallacy, he said.

“This is similar to walking in a Las Vegas casino and seeing the numbers that just hit lit up on the roulette table,” Matson said. “There is a reason they display the recent performance of the table. People think they see a pattern and know if a black or red number is coming up next which entices them to bet, but in reality the next spin is completely random, unpredictable and uncorrelated to the previous spins just like active management.”

Everything in Moderation

The latest market performance should not dictate when investors should allocate more funds to equities since the best strategy is to take a long-term view.
“The market being at an all-time high should not alter their feelings about whether being in the market right now is the right thing to do,” he said. “The best time to be prudent is now and trying to time the market is not prudent.”

Continuing gains in the market should be a concern for investors, said Jeff Sica, CIO of Circle Squared Alternative Investments in Morristown, N.J. A pullback is likely to occur so that the markets reach a more “normal” level.

“It may not happen immediately since we have repeatedly seen new highs, but according to history, we will see a decline at some point,” he said. “Anytime the markets set new highs, trepidation creeps into investors' thoughts and there is usually a selloff.”

Trying to time when a dip may occur is foolhardy, since a drop may not occur before the end of 2014 or even soon after the new year.

“It will most likely occur at some point in 2015,” he said. “For now, investors should keep an eye on oil prices because oil has dominated the headlines in the market and will continue to do so as long as prices are this low.”

Correctional Facility? Avoid Emotion

The market is definitely due for a correction in 2015 and more volatility will occur, said Jimmy Lee, CEO of the Wealth Consulting Group in Las Vegas.

“My hope is that while the equity markets may continue to sell off that good economic data, we might have a surprise for the end of the year,” he said. “The question is whether the U.S. will be able to continue to grow despite global concerns. Without the stimulus from the Fed, the markets will need earnings to keep up, so valuations don’t get out of whack.”

The market can not continue to rise forever and stay in a bull market, said Matt Tuttle, CEO of Tuttle Tactical Management, a Stamford, Conn. firm that provides customized tactical ETF-based investment strategies and asset management.

“You have to get to that capitulation point before the bubble bursts,” he said. “At some point, they run out of bullets. When that happens, that is when it gets real ugly. Headlines have noted that this is the worst year for active managers in decades. They all need to catch up before year-end and they will buy on all dips, which will not allow the market to make a big downturn until at least next year.”

Owning equities is not for the faint-hearted, said Richard Gotterer, managing director of the Wescott Financial Advisory Group's office in Miami.

“When you invest in the stock market, you have to be somebody who is optimistic,” he said. “Investing in the market is about future potential, the economy and the companies you invest in.”

Staying in the market means investors can have the benefit of being able to dollar cost average and buy during the lows, Gotterer said.

“We’re pretty optimistic about equities,” he said. “Investing is a long-term game and investors need to have realistic expectations of what market returns should be. Corrections and pullbacks are quite common."

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While it makes sense that some investors expect a market drop after reaching highs, a pullback is far from guaranteed, said Ben Sullivan, a Scarsdale, N.Y. certified financial planner with Palisades Hudson Financial Group.

Investors who bailed out when the market first started hitting new all-time highs in late 2012 would have missed out on the nearly 30% gains that have occurred, he said.

"Even professionals can't successfully time the market," Sullivan said. "Instead, investors should focus on developing a long-term investment plan based on how much risk they can handle."

--Written by Ellen Chang for MainStreet