Market timing: a picture is worth a thousand words

They say a picture is worth a thousand words.

I could easily spill a thousand words on market timing.

I could talk about how each trade involves a willing buyer and seller; each with equal interests, each with the same access to information.

I could talk about the fact that, over about 85 years, the S&P 500 has only gone up 51.02% of the days.[i]

I could talk about the concentrated nature of returns. I could show that being out of the market, and missing the best month each year, drops returns by about 7% per year.[ii]

I could talk about a psychologist from Berkeley, named Philip Tetlock - who studied over 82,000 varied predictions, by 300 experts, from different fields, over 25 years - and concluded that expert predictions barely beat random guesses. Ironically, the more famous the expert, the less accurate his or her prediction tended to be.[iii]

I could talk about Nobel Prize winner Bill Sharpe's contention that timers need to be right 74% of the time, to overcome the frictions and costs of their moves.[iv]

I could talk about magazine covers, like the Death of Equities[v], that featured just before five years of 14.44% average compound returns for the S&P 500.[vi]

I could talk about how studies - ranging from the landmark paper by Brinson, Beebower and Hood[vii], to the most recent study on NZ managed funds - have found that the average contribution of market timing to returns is negative.[viii]

I could talk about a study of 1,557 managed funds and 210 institutional funds, where the author concluded timing ability of managers is, on average, negative.[ix]

I could talk about how the majority of market timing newsletters underperform the market.[x] I could talk about how, on average, market timing newsletters underperform the market by over 4.00%.[xi]

I could talk about how the market timing gurus whose calls are tracked, have less than 50% accuracy.[xii]

I could talk about evidence that shows economists can't time markets either.[xiii]

I could talk about how the predictive power of last year's return, to correctly forecast this year's return, is 0.01%.[xiv]

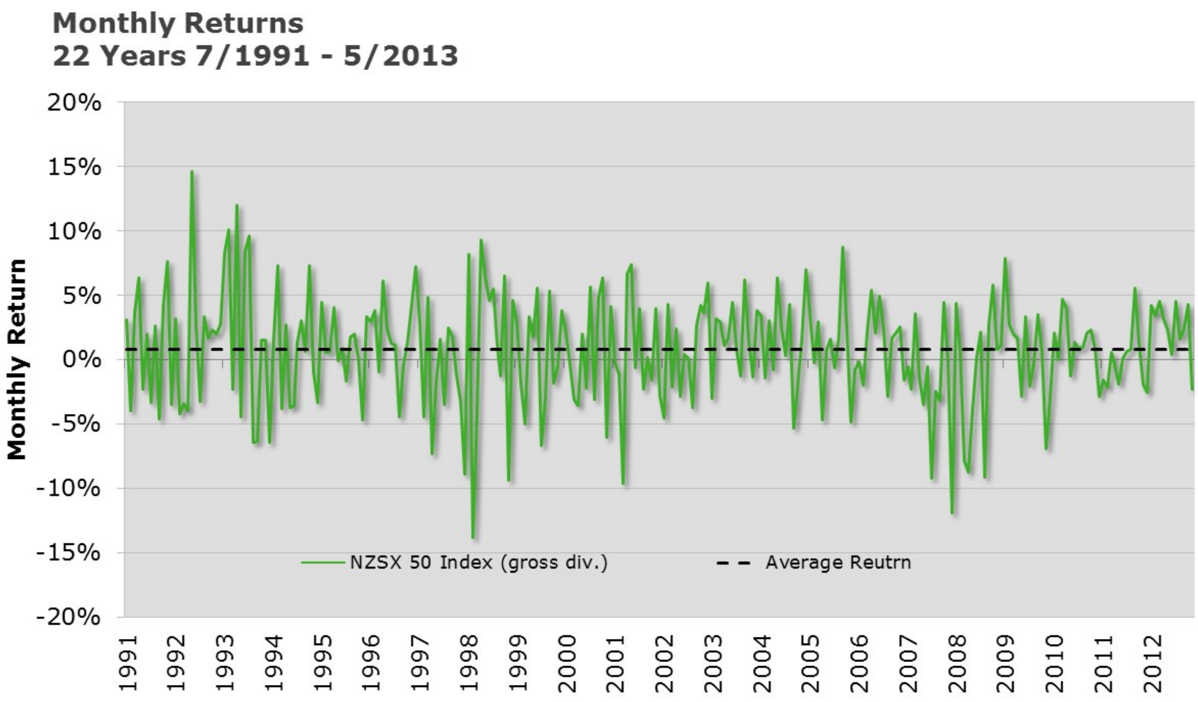
I could talk about the wise words of Warren Buffett, who said, "The only value of (share) forecasters is to make fortune tellers look good."[xv]

I could talk about the simple logic that all market timing calls offset each other. If you buy, someone must sell. If you sell, someone must buy.

I could talk about a lot of things.

Or…

I could show you this picture of monthly returns and simply ask you to find the pattern.



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[i] www.ifa.com, "Positive vs. Negative Returns in Various Time Periods", 85 Years, 5 Months (1/1/1928 – 5/31/2013); S&P 500

[ii] NZX and Returns 2.0. Calculations performed by NZ Wealth. Returns gross of all fees and taxes

[iii] Burton Malkiel and Charles Ellis, "The Elements of Investing"

[iv] Sharpe, William, "Likely Gains From Market Timing", Financial Analysts Journal, March – April, 1975

[v] http://www.businessweek.com/stories/1979-08-13/the-death-of-equitiesbusinessweek-business-news-stock-market-and-financial-advice

[vi] http://www.ifa.com/portfolios/PortReturnCalc/index.aspx?i=SP500&s=9/1/1979&e=8/1/1984&type=indices&g=1&infl=False&tax=False&wort=0&perc=False&wortinf=False&aorw=1&gp=False&log=False&gy=False&xp=False&iar=False&af=False#calc

[vii] Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, "Determinants of Portfolio Performance", Financial Analysts Journal, July-August 1986, pp. 39-44; and Gary P. Brinson, Brian D. Singer and Gilbert L. Beebower, "Revisiting Determinants of Portfolio Performance: An Update", 1990, Working Paper.

[viii] Rob Bauer, Roger Otten, Alireza Tourani Rad, "New Zealand mutual funds: measuring performance and persistence in performance," Accounting and Finance 46 (2006) 347–363

[ix] Wei Jiang, "A Nonparametric Test of Market Timing." Journal of Empirical Finance 10 (2003) 399– 425

[x] Hulbert Financial Digest, Businessweek 9/3/1998

[xi] Market Timing Ability and Volatility Implied in Investment Newsletter Asset Allocation Recommendations" National Bureau of Economic Research Paper #4890

[xii] www.cxoadvisory.com/gurus/

[xiii] SMH/Age Economists' Survey, Jan 6, 2008; Jan 3, 2009; Jan 2, 2010; Dec 31, 2010;

[xiv] http://www.ifa.com/12steps/step4/step4page2.asp#ChartFlashID86

[xv]http://www.cbsnews.com/8301-505123_162-37841089/the-smartest-things-ever-said-about-market-timing/