viewpoint

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Boring Quarter?

If one opened the business section of a newspaper at the end of March and compared it to the previous quarter's end, you would think this had been a boring three months. The US stock market averages are largely unchanged from year-end with large companies up a little and small companies down a little. The only difference in the international markets is that emerging market equities are up slightly while the broader developed international market is down slightly. A somewhat boring start to the year…or, is it?

If you were a market watcher, you saw things differently. January started off with four of the first five trading days being down with the S&P 500 index dropping nearly 6% during this period. At one point in January, the S&P was down 11% with small and international indexes down even more. Not a very boring market if you're watching the day-to-day movements.

In early January, three items were worrying the financial markets: falling oil prices, a slowing economy, and the Federal Reserve's interest rate policy. But, as the quarter progressed the worries subsided and the market rebounded.

Quick drops in the market followed by rebounds have become commonplace in the current bull market. Since the market bottom in 2009, the S&P 500 index is up tremendously despite experiencing six separate market declines of 5% or greater with the largest being down 19%.

Market volatility is nothing new or unusual. In fact, it has been the norm since 1980. Since then, 23 of the 36 years had a double-digit drop during the year; and, every year had a decline of at least 5%. The average inter-year drop during the 36 years was 14.2%. Yet the market was up 27 of the 36 years or 75% of the time. If you had invested $1,000 in an S&P 500 total return fund in 1980, it would now be worth over $40,000 – a return of over 11% per year.

You would think this level of volatility would be ideal for market timers – simply miss the down drafts and their returns would be incredible. In practice, however, this isn't what happened as *time in the market* was far more important than *timing the market*. To demonstrate this, Schwab's Center for Financial Research looked at 20 years of market returns from 1995-2014. During this period of 5,040 trading days, the S&P 500 had a total return of 9.9% per year. However, if you missed the largest 40 positive days, your return would be -0.5% per year. Even if you were an awesome market timer and only missed the best 10 days, your return would have been 6.1% per year.

Of course, this study isn't new – we recall studying similar statistics while in training during the 1980's. Still, many investors attempt to time the market. Even devout long-term investors can let their emotions get the best of them and pull out of a market for all the wrong reasons at all the wrong times. This can be illustrated in two separate studies, one from the Investment Company Institute and the other by Dalbar Inc.

The Investment Company Institute study tracked mutual fund money flows and found that in every year except one, from the beginning of the current bull market until today, investors had pulled more money out of equity funds than they had added. It also highlighted that those who completely withdrew from the market in 2009 and remained in cash, missed an impressive 186% return.

The Dalbar Inc. study compared how the average investor's returns over the past 20 years did compared to indexes. They do this by utilizing the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. As mentioned earlier, the S&P 500 average annualized return during this period was 9.9%; a portfolio of 60% S&P 500 and 40% fixed income it would have been 8.7%. Interestingly, the average fund investor only made 2.5% during this period.

To us, the moral of this story is simple: equity markets are rarely boring on a short-term basis; but, we think our approach to investing should be.

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