Client's Corner

The One Way to Be Sure to Catch All of a Major Market Advance

AS I WRITE, ON THE EVENING OF MONDAY, JANUARY 13, 2020, the Standard & Poor's 500-Stock Index has just closed at 3,288. (It will be higher or lower by the time you read this, and that will be entirely irrelevant to the point of this little essay.)

On Christmas Eve 2018, it closed at 2,351. Thus, in 13 months less 11 days, it's gone up 40%.

But of course, that's not the whole story. You see, in these 13 months, the companies in the Index paid cash dividends equivalent to about 2% of its value. Thus, the total return of the S&P 500 has actually been closer to 42%. The question then becomes: ***what did one have to do to be sure of earning that 42%?***

After a sudden, savage, 95-day, 19.8% decline, *were you, in fact, still in your seat and strapped in when they mercifully rang the closing bell on December 24th—the worst Christmas Eve in market history?*

The obvious (and too narrow) answer is: you had to own a security that essentially replicates the S&P 500—say, an index fund. This leads to an even larger realization; indeed, one might almost call it an epiphany. To wit: ***you needed to own it when the market closed on Christmas Eve 2018.***

That's because the equity market rocketed upward right from the opening bell the day after Christmas. So if you weren't already strapped in when that rocket blasted off, you missed some (possibly significant) part of the return. (Not to belabor this point, but the first 5% of the 40% advance took place that one day: December 26. You can look it up.)

Ah, but that raises the essential question, which is: **after a sudden, savage, 95-day, 19.8% decline, *were you, in fact, still in your seat and strapped in when they mercifully rang the closing bell on December 24th—the worst Christmas Eve in market history?***

Well, you were or you weren't. Either way, I think you can clearly see where this is going, but allow me to spell it out. ***For all practical purposes, the only way you could have been sure of capturing the whole advance was to have sat through the whole decline.*** Indeed, ***the advance may properly be regarded as your reward for enduring the decline.***

Like all the market declines that preceded it, the September 20–December 24 drawdown in 2018 proved temporary; as I write, the much larger advance is ongoing. This is not to be taken as an implied prediction, but as a simple statement of fact.

In fairness, let us consider an alternative hypothesis: that it may be possible for the investor, over long periods of time, to be in the market for much or most of a major market advance, while being out for much or most a major decline. In other words, that one might with some consistency gain a timing advantage over the market's long-term return.

Permit me to doubt that this has ever been your personal experience, or that of anyone of whom you know. (You didn't ask, but I assure you that I've never been able to do it, nor has anyone I know of.) I would like to go a step further and suggest that it can't be done, but I wouldn't know how to go about proving that to you. So I'll stop at expressing my belief that it can't, and invite you to ask your financial advisor—the one who sent you this essay—whether he or she agrees.

I'm pretty sure I know what your advisor will say.

© February 2020 Nick Murray. All rights reserved. Used by permission.