BUSINESS INSIDER
By **Sam Ro**
October 26, 2014

If You Missed The Rally, Then You Just Made The Most Classic Mistake In Investing

REUTERS/Sue Ogrocki

The past two months have been challenging for stock market investors. The S&P 500 quickly tumbled 9.8% from its Sept. 19 all-time high of 2,019 to as low as 1,820 on Oct. 15.

Because of the way our brains work, most of us worried about the possibility that this correction was turning into an outright market crash. Our instinct was to dump stocks. Surely, many investors sold and told themselves they would "wait out the volatility" on the sidelines. A confident few likely even shorted the market.

However, history shows this is the most classic mistake investors make. So, kudos to those who held on to their long positions.

"Corrections are part and parcel of the investment process, they come and go, and it is imperative to take a deep breath and realize that what is most important for building wealth is not 'timing' the market but rather **'time in' the market**," David Rosenberg said on Oct. 14. The S&P is up nearly 8% since Rosenberg wrote that.

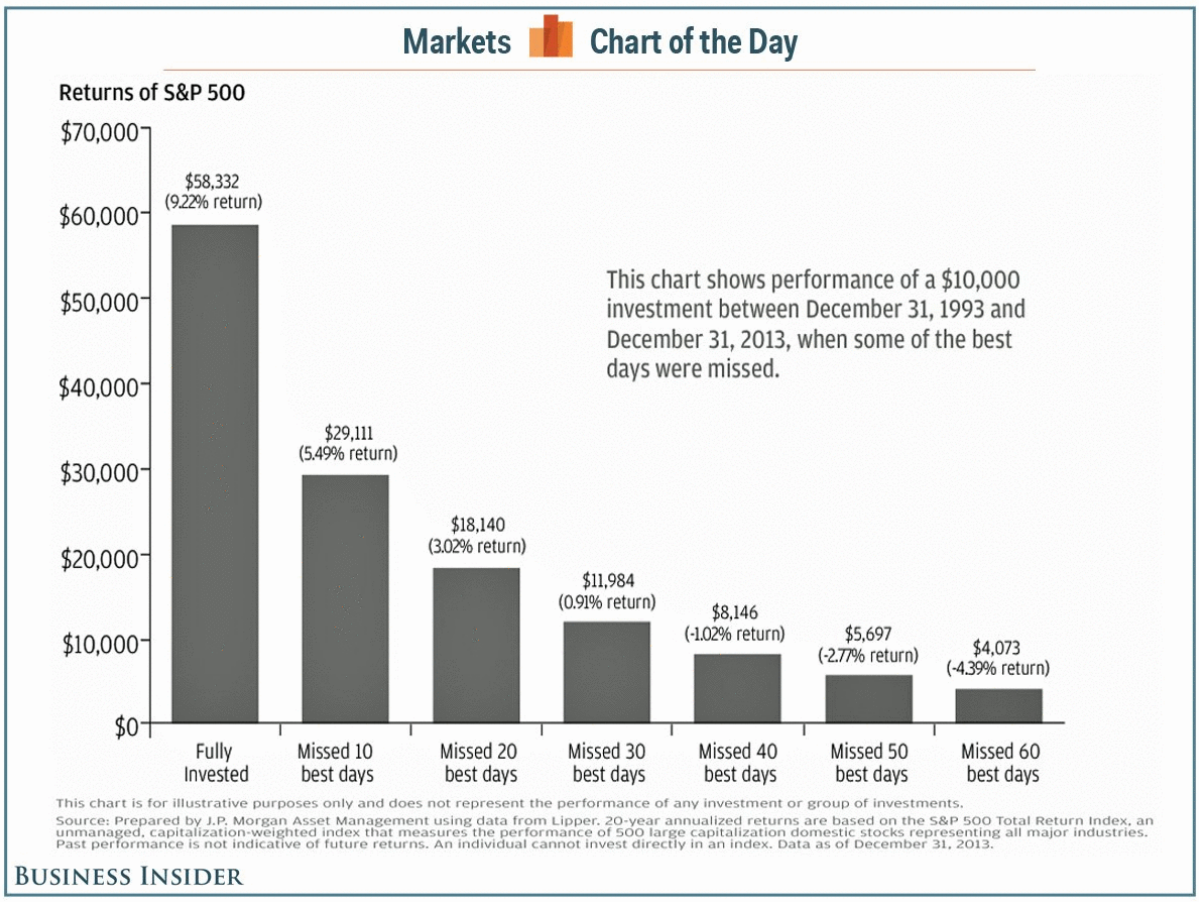
"Time in" the market is crucial, especially when things get scary for investors. There's tons of data on this. We talk about it all of the time. Even the folks who sold the sell-off probably know about it. But let's revisit some of the data anyway.

Missing A Few Good Days Will Destroy Your Long-Term Returns

When volatility picks up, it's tempting to trade in and out of the market with the hope you'll protect your wealth. Unfortunately, this increases the risk you'll miss some of the best days in the market. And that can be very costly.

JPMorgan Asset Management illustrated how much an investor's returns collapsed when they missed a few of the best days in the market. They found that if an investor stayed fully invested in the S&P 500 from 1993 to 2013, they would've had a 9.2% annualized return.

However, if trading resulted in missing just the ten best days during that same period, then those annualized returns would collapse to 5.4%.



JP Morgan Asset Management

Missing these days do so much damage because those missed gains aren't able to compound during the rest of the investment holding period.

"Plan to stay invested," they recommend. "Trying to time the market is extremely difficult to do consistently. Market lows often result in emotional decision making. Investing for the long-term while managing volatility can result in a better outcome."
The Best Days In The Market Come After The Worst Days

Some of the worst days in the market follow down days in the market. That seems to make sense intuitively.

However, some of the best single days in the market also follow some of the worst days. Here's a table from Wikipedia putting the S&P 500's 20 worst days next to 20 best days.

Largest daily percentage losses

Rank	Date	Close	Net Change	% Change
1	1987-10-19	224.84	-57.86	-20.47
2	2008-10-15	907.84	-90.17	-9.03
3	2008-12-01	816.21	-80.03	-8.93
4	2008-09-29	1,106.42	-106.85	-8.81
5	1987-10-26	227.67	-20.55	-8.28
6	2008-10-09	909.92	-75.02	-7.62
7	1997-10-27	876.99	-64.65	-6.87
8	1998-08-31	957.28	-69.86	-6.80
9	1988-01-08	243.40	-17.67	-6.77
10	2008-11-20	752.44	-54.14	-6.71
11	1962-05-28	55.50	-3.97	-6.68
12	2011-08-08	1,119.46	-79.92	-6.66
13	1955-09-26	42.61	-3.02	-6.62
14	1989-10-13	333.65	-21.74	-6.12
15	2008-11-19	806.58	-52.54	-6.12
16	2008-10-22	896.78	-58.27	-6.10
17	2000-04-14	1,356.56	-83.95	-5.83
18	2008-10-07	996.23	-60.66	-5.74
19	1950-06-26	18.11	-1.03	-5.38
20	2009-01-20	805.22	-44.90	-5.28

Largest daily percentage gains

Rank	Date	Close	Net Change	% Change
1	2008-10-13	1,003.35	+104.13	+11.58
2	2008-10-28	940.51	+91.59	+10.79
3	1987-10-21	258.38	+21.55	+9.10
4	2009-03-23	822.92	+54.38	+7.08
5	2008-11-13	911.29	+58.99	+6.92
6	2008-11-24	851.81	+51.78	+6.47
7	2009-03-10	719.60	+43.07	+6.37
8	2008-11-21	800.03	+47.59	+6.32
9	2002-07-24	843.43	+45.73	+5.73
10	2008-09-30	1,113.78	+59.94	+5.42
11	2002-07-29	898.96	+46.12	+5.41
12	1987-10-20	236.83	+11.99	+5.33
13	2008-12-16	913.18	+44.61	+5.14
14	1997-10-28	921.85	+44.86	+5.12
15	1998-09-08	1,023.46	+49.57	+5.09
16	1970-05-27	72.77	+3.48	+5.02
17	2001-01-03	1,347.56	+64.29	+5.01
18	1987-10-29	244.77	+11.49	+4.93
19	2008-10-20	985.40	+44.85	+4.77
20	2000-03-16	1,458.47	+66.33	+4.76

Wikipedia

This is just the nature of how the stock market moves. Bear markets don't go straight down and bull markets don't go straight up. When you look closely, they are marked by good and bad days, good and bad weeks, and so on. During periods of volatility, the magnitude of up-moves are just as big as the magnitude of down-moves.

Investors Buy High And Sell Low

So far, we've been largely talking about hypotheticals. Now, let's take a look at how bad we really are at investing.

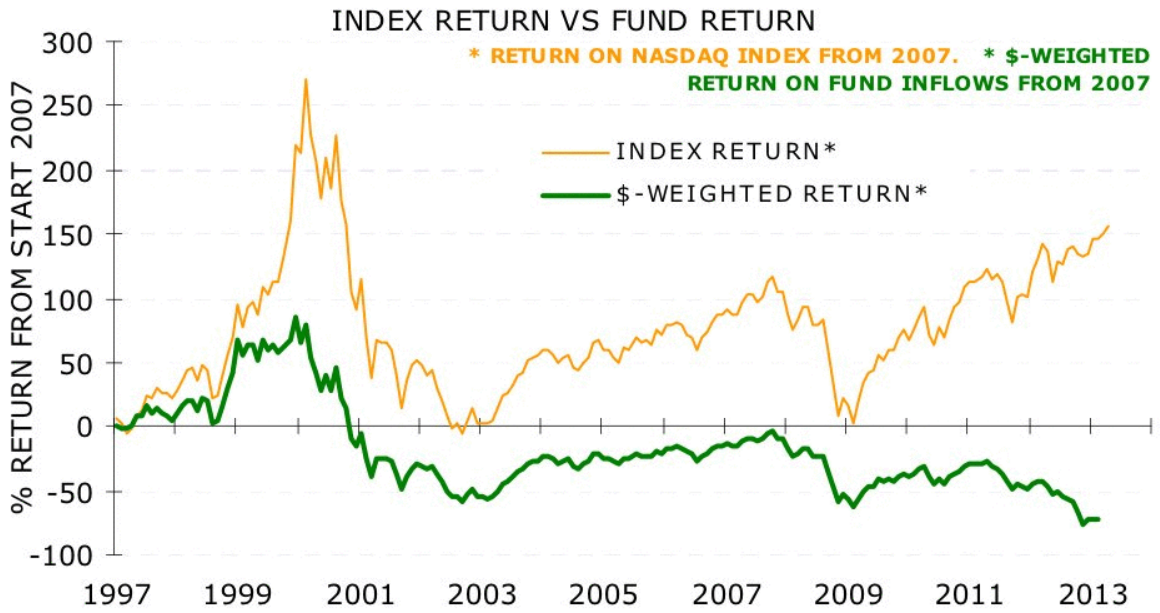
Last year, investment strategist Gerard Minack studied the timing and volumes mutual fund flows to see how investors' actual returns compared to movements in the market. As expected, he found that inflows became most aggressive as markets peaked and outflows ramped up when markets were near their lows.

As a result, the dollar-weighted return of the investors' portfolios lagged the benchmark indexes by extremely wide margins.

"As more money went in at high price levels, and money was withdrawn at low price levels, the dollar-weighted return was significantly less than the index return," Minack found. "A $100 lump sum investment made at the start of 1997 – a 'buy-and-hold' investment – would [in May 2013] be worth $150 (ignoring dividends). The dollar-weighted returns –which I have calculated assuming that the funds achieved the same return as the NASDAQ – would have lost 75%."

Exhibit 4

Index Return Versus Dollar-weighted Return



Source: Bloomberg, ICI, Morgan Stanley Research

Morgan Stanley

In other words, investors were just fantastic at being exposed to the market only when it was sliding.

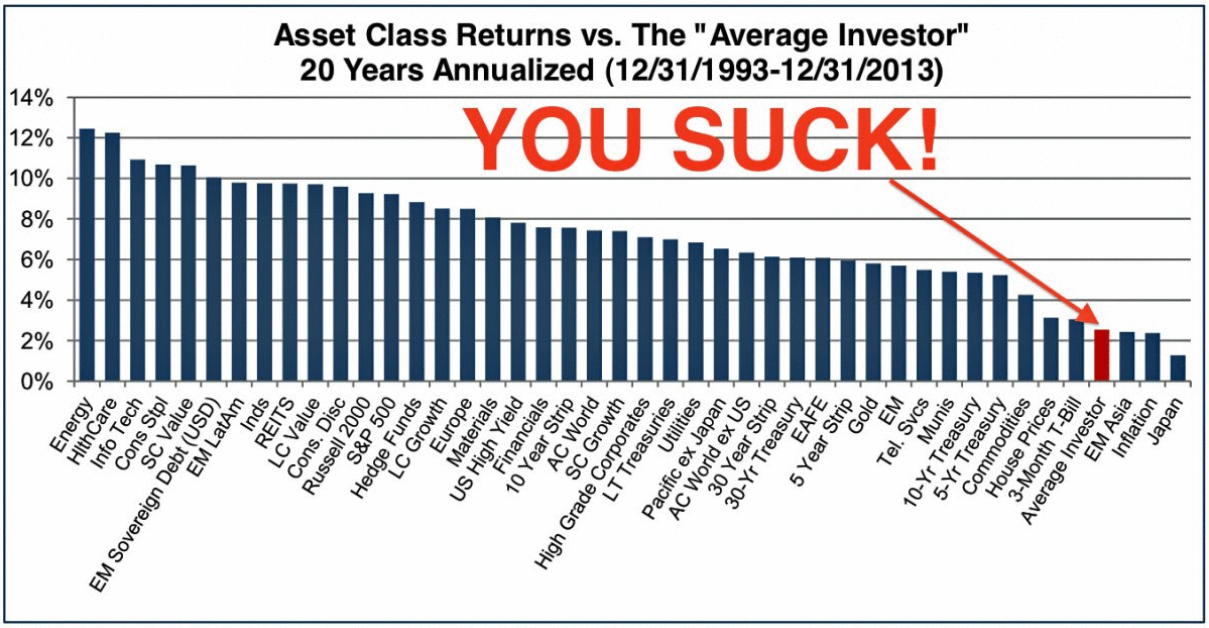
You Are 'Shockingly' Terrible At Investing

There are countless studies that deliver the same message as Minack.

Richard Bernstein of Richard Bernstein Advisors recently shared the results of study comparing the annualized returns of around 20 asset classes over a 20-year period. It included the performance of the typical investor.

"The performance of the typical investor over this time period is shockingly poor," Bernstein wrote. "The average investor has underperformed every category except Asian emerging market and Japanese equities. The average investor even underperformed cash (listed here as 3-month t-bills)! The average investor underperformed nearly every asset class."

Ironically, this typical investor is actually underperforming the very assets they invest in.



Source: Richard Bernstein Advisors LLC., Bloomberg, MSCI, Standard & Poor's, Russell, HFRI, BofA Merrill Lynch, Dalbar, FHFA, FRB, FTSE. Total Returns in USD.
Average Investor is represented by Dalbar's average asset allocation investor return, which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior.
Richard Bernstein Advisors

"They could have improved performance by simply buying and holding any asset class other than Asian emerging market or Japanese equities," Bernstein added. "Thus, their underperformance suggests investors' timing of asset allocation decisions must have been particularly poor, i.e., investors consistently bought assets that were overvalued and sold assets that were undervalued."

Let's Be Very Clear About Something...

We're not proposing that we won't see the stock market fall again tomorrow or the next day. We certainly can't rule out the ever-present risk that the market could soon crash.

But, that's just part of investing in the stock market. If you aren't prepared to lose tremendous amounts of value, you shouldn't be in stocks.

And once you're in, you better be prepared for the volatility. Time and time again, investors aren't willing to put their "time in" the market when the market has the most wealth to offer.

Have you gotten lucky by investing in a particular company's stock? We'd love to hear your stock picking success stories for an upcoming article: yfmoneymailbag@yahoo.com.