DANIEL GOLDIE, CFA, CFP®
dgoldie@buckinghamgroup.com
650.566.1121

DIRK GILLIARD
dgilliard@buckinghamgroup.com
650.566.1111

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Many important decisions in investing are counterintuitive. The right thing to do often goes against our instincts. This makes it hard for most of us to consistently make smart financial decisions. One of the many advantages of following an evidence-based investment strategy is that we are forced to follow what the data tell us. In other words, we want to follow what actually works based on historical evidence rather than what seems like it should work.

Take the value of the U.S. stock market right now. To many observers the major averages like the S&P 500 seem too high given the current economic reality, pandemic restrictions and upcoming election uncertainty. The market seems out of touch because our intuition suggests that current prices should be consistent with the current environment.

But the stock market does not work in the present. It sets prices today based on earnings and economic expectations quarters and years into the future. This is why markets often hit bottom before a recession ends and start declining before a recession begins. The market may turn out to be wrong but investors appear to be pricing in an earnings and economic recovery in 2021 and beyond. In addition, the Federal Reserve is pumping unprecedented amounts of liquidity into the economy, which is significantly bolstering asset prices.

Because of all this we have been getting questions like this lately: "Should I invest new money in the market now or wait for a correction?" Many are also wondering if they should temporarily get out of the market to avoid the likely volatility due to the upcoming presidential election. To answer these questions, let's consider some historical evidence.

If we look at the last 94 years since 1927 in the S&P 500, here is what we see:

- If we remove the returns of the best 94 months (an average of just one month a year), the average return of the remaining 1,034 months is virtually zero (0.1%). In other words, 8.3% of the months provided almost 100% of the returns.

- The best-performing 94 months, an average of just one month a year, earned an average return of 10.4%.

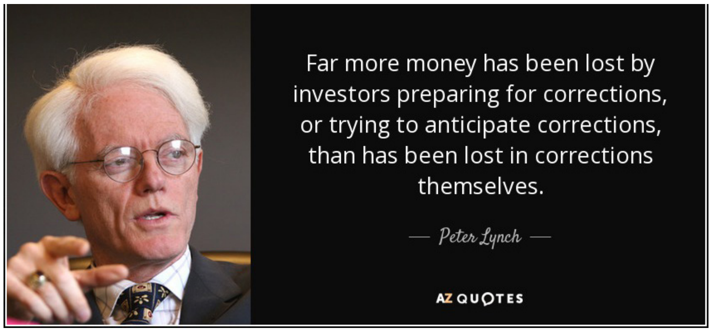
- While the average quarter returned 2.9%, if we eliminate the best-performing 94 quarters, the remaining 282 quarters (three-fourths of the time period) lost money, providing an average return of -0.8%. In other words, just 25% of the period provided more than 100% of the returns.

- The best-performing 94 quarters, an average of just one quarter a year, earned an average return of 14.1%.

The conclusion we draw is that markets have performance bursts—large gains compressed into very short periods of time—that deliver virtually all their long-term gains. Therefore, if we are not constantly invested to capture all of these bursts, we risk significantly reducing our long-term gains. Miss just one and our returns can be significantly reduced.

The investment firm Elm Partners added some additional insight by looking back at 115 years of data to answer the following question: "During times when the market has been 'expensive,' what has been the average cost or benefit of waiting for a correction of 10% from the starting price level, rather than investing right away?" The company defined "expensive" as the occasions in which the stock market had a CAPE ratio (an adjusted measure of price/earnings) more than one standard deviation above its historical average.

They found the following:



Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves.

— Peter Lynch —

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- From a given “expensive” starting point, there was a 56% probability that the market had a 10% correction within three years, waiting for which would result in about a 10% return benefit versus having invested right away.

- In the 44% of cases where the correction doesn’t happen, there’s an average opportunity cost of about 30%—much greater than the average benefit.

- Putting these together, the mean expected cost of choosing to wait for a correction was about 8% versus investing right away.

Elm says that the reason investors believe waiting for a correction is a profitable strategy is because “while a correction occurring is indeed more likely than not, investors may confuse the chance of a correction from peak-to-trough with the lower chance of a correction from a fixed price level. For example, the historical probability of a 10% correction happening any time during a 3-year window is 88%, significantly higher than the 56% occurrence of that correction from the market level at the start of the period.”

Elm repeated its analysis with correction ranges from 1% to 10%, time horizons of one year and five years, and an alternate definition for what makes the market look “expensive” (specifically, waiting for a correction from times when the market was at an all-time high at the start of the period).

The firm found that “across all scenarios there has been a material cost for waiting. The longer the horizon that you’d have been willing to wait for the correction to occur… the higher the average cost.”

Investment success comes in large part from having patience and discipline. We agree with superstar investor Peter Lynch who once said, “Far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in corrections themselves.” The best decision of when to invest is to do so immediately in a lump sum when you have the money available. If doing that is too uncomfortable, we should follow a dollar-cost averaging strategy over as short a period as we can handle. Our view is that this approach offers us the highest probability of success.

As always, thank you for you continued trust and confidence.

Warm regards,

Dan   Dirk

Daniel C. Goldie   Dirk G. Gilliard

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