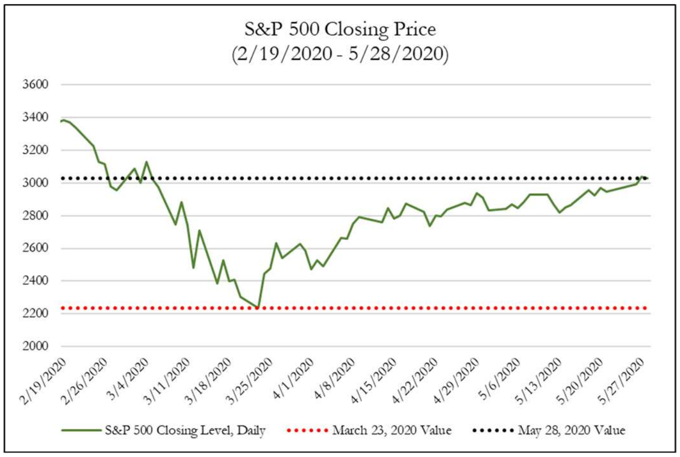
When Doing Nothing Is The Best Option

The last few months have been, for lack of a better term, an emotional roller coaster for investors. On February 19, 2020, the S&P 500 stock index hit an all-time high. Between then and March 23rd, just over one month, the same index had sold off almost 34% of its value as markets reeled from business closures and what felt like the uncontrollable spread of the novel coronavirus. Now, a little over two months from the bottom, the S&P 500 has recovered significantly from March lows thanks to government stimulus and stay-at-home measures that have helped curtail the spread of the virus.



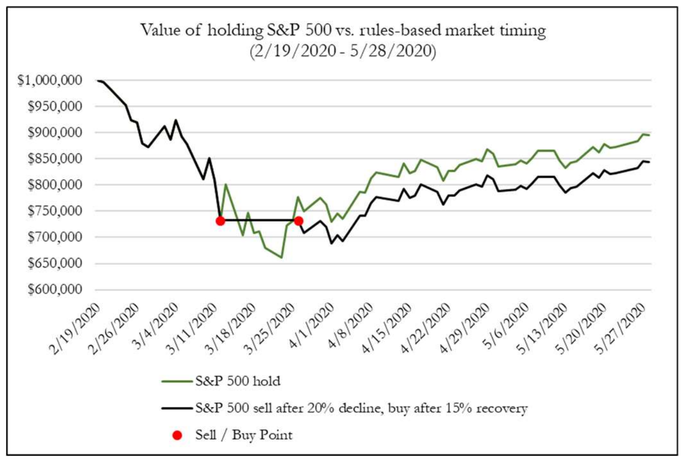
Source: Yahoo! Finance

When markets were in free-fall in March, many investors likely called advisors wanting to sell a portion or all assets, convinced that markets would continue to fall and not recover. Herein lies the question: would these clients, based on what we know now, have been better-off selling at any point over the last few months and remaining in cash? The answer to that question is: “probably not.”

For simplicity, we are assuming that investors can hold the S&P 500 Index and that they can sell the index for the close-of-day price. Between February 19, 2020 and May 28, 2020, there were a total of 70 total trading days for the S&P 500. Of those days, clients would have been better off holding their investment in the index 61 of those 70 days. Investors that sold would have been better off only nine times out of 70, and this does not even consider the impact of taxes or other costs to transacting.

“But wait,” you may think, “I wouldn’t have just sat in cash this whole time – I would have gotten back into the market at some point.” The problem with this statement, other than hindsight bias, is that the odds of perfectly timing both the peak of the market and bottom of the market are so small. Even investors that understand this will often concoct “rules” as to when to sell and when to reinvest because having rules makes them feel safer. By and large, these rules give an illusion of control and often perform worse than maintaining the investment.

To illustrate this point, consider the following rule applied to the last few months: sell when the S&P 500 drops by 20% and do not reinvest until the index recovers 15% from when it bottomed. Assuming an investment of one million dollars, an investor using that rule would have underperformed holding that investment by about $50,000. Keep in mind that this also ignores other factors such as taxation and trading costs that would further negatively impact this strategy in some situations.



Source: Yahoo! Finance

Although some markets have recovered substantially from lows, there is still a possibility of another selloff over the next few months or years due to the virus or some other external shock. However, even if we do see another bout of volatility and markets retest lows, our core beliefs still stand: it is very difficult to time the market, a diversified portfolio helps to dampen volatility and achieve client goals, and it is most important to maintain a long-term time horizon when investing.

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Data Source: Yahoo! Finance

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