More on market timing

October 15, 2008 7:01 am

I wrote here that I was fed up of hearing the irrelevant statistic that “A portfolio belonging to an investor who missed the 10 best days over several decades across all of those markets would end up, on average, with about half the balance of someone who sat tight throughout.”

I wanted to know how much better off you’d be if you managed to miss the WORST ten days. Javier Estrada kindly writes:

Dear Tim,

I wrote the ‘Black Swans’ paper cited in the NY Times. And I agree with your point above: “I could equally make the opposite case by observing how much money you would save by being out of the market on the worst days. I mean, there was the 1987 crash – about 25 per cent. There have been several days of losses in excess of 5 per cent in the past few weeks. Just imagine how much better off you’d been if you had missed the ten worst days of the market...”

That is precisely what I show in my paper. If you take a look at it, across the 15 markets I consider, not only do I establish that missing the best 10 days would have reduced the return by 50.8% (relative to a passive strategy) BUT ALSO that avoiding the worst 10 days would have increased the return by 150.4% (again relative to a passive strategy).

My point in this comment is that the argument is the same in both cases: A negligible proportion of days (black swans, outliers, however you want to call them) have a massive impact on long-term performance.

So it doesn’t matter whether you make the argument in terms of
winning or losing, the point is that investors are very unlikely to pick the right days to be in and out of the market; hence, market timing is a goose chase.

Best,
Javier

Quite. Thanks, Javier! Shame the New York Times didn’t report that part of his work.