

Seeking Alpha^α

Financial Advisors | Portfolio Strategy | Editors' Picks

Not Timing The Market, But Taking Precautions: Financial Advisors' Daily Digest

Sep. 1, 2017 9:31 AM ET 14 comments

by: SA For FAs

Summary

- Adam M. Grossman, CFA, offers a few snippets of timeless wisdom from America's first personal finance expert, Benjamin Franklin.
- Nicholas P. Cheer: The bull market in bonds is not over.
- Eric Parnell, CFA, makes the case for “diversification for the long run” over “stocks for the long run.”.

The classic argument for buy-and-hold investing is that only a small number of blowout days contribute lopsidedly to returns. Miss those days by being out of the market at the wrong time, and your returns will be mediocre, despite whatever attention you pay to timing your investing moves. IESE Business School professor **Javier Estrada** put it particularly aptly in a research paper he published 10 years ago:

The evidence from 15 international equity markets and over 160,000 daily returns indicates that a few outliers have a massive impact on long term performance. On average across all 15 markets, missing the best 10 days resulted in portfolios 50.8% less valuable than a passive investment; and avoiding the worst 10 days resulted in portfolios 150.4% more valuable than a passive investment. Given that 10 days represent less than 0.1% of the days considered in the average market, the odds against successful market timing are staggering.”

I find this convincing and therefore agree it is worthwhile to hold stocks for the long term. But if you really think about, one clear implication is that stock returns will frequently deliver heartache. And, given the reality of mean reversion, it stands to reason that the long bull market in stocks could be followed by a long stretch of disappointing returns. Without offering specific predictions, and without advocating selling long-term stock holdings, this strikes me as a fair implication.

I think two articles on today's Seeking Alpha in a sense underscore this notion quite well. The first is from new contributor Adam M. Grossman, CFA, who takes a step back and offers a few snippets of timeless wisdom from America's first personal finance expert,

Benjamin Franklin. I've noted my admiration for Franklin in the past. Grossman conveys some of his 18th century advice, translating it into contemporary terms. Here's one example:

On avoiding complacency, Franklin cautioned against ever concluding that, 'It is day, and will never be night.' Or, to put that in today's terms, if the Dow Jones Industrial Average is at 21,000 and you feel like it will probably just keep going, be careful."

Meanwhile, veteran SA contributor Eric Parnell, CFA, in an article entitled "Diversification for the Long Run," shows how a portfolio equally divided between stocks, T-bills, Treasuries, and gold has performed during various market periods, including ones where stocks took front stage and those where they performed poorly. The answer is – not bad! Parnell's portfolio is more conservative than the allocation I favor, but that only enhances his argument, which is that you can achieve a decent return *and* sleep well at night. I quote:

This is why I still choose diversification that includes stocks over just stocks only for the long run. For unless we think that we are now about to enter an extraordinary period like 1950-1968 or 1995-1999 where stocks are going to completely blow the doors off of all other major asset classes, it is more reasonable to think that we are going to see more balanced returns...and asset class leadership rotating in and out of favor at any given point in time. "

Optimizers, understanding that stocks' risks lead to higher long-term returns, don't want to leave any money on the table. But if we're also optimizing for peaceful sleep and financial flexibility, a significant cash allocation makes sense. And, if we're seeing record-long bull markets, who's to say we won't see a record long bear market? Some kind of bear market, in any event, will surely come – as night follows the day.

We welcome your thoughts in our comments section, as always. For now, here are other financial advisor-related links:

- Lance Roberts: Consumer debt has reached a new all-time record.
- Jeff Miller offers a brief tutorial on how to interpret the August employment data.
- Jeff Miller's Stock Exchange panelists discuss stock ideas and the biggest cause of trading failure.
- Dirk Cotton describes three degrees of retirement plan failure.
- Russ Thornton shares his perspective on planning for early retirement.
- For more content geared to FAs, visit the Financial Advisor Center.