MarketWatch

Why you should ignore October crash warnings

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As we enter October, pundits will remind you that the markets' biggest crashes have come in this month.

Fears of rising geopolitical tensions between Russia and Ukraine, the rising violence at the hand of ISIS, political turmoil in Pakistan, all and then some will be brought up to create anxiety and fear among investors. And with the Standard & Poor's 500 Index SPX, -0.25% sitting at all-time highs, many will ask themselves "is this the market top? Should I sell?" After all, who isn't afraid of losing their hard earned nest egg.

But should you act on these fears? When are they rational versus contrived?

Investor psychology is remarkable. We tend to remember our successes and all too often forget or ignore the lessons of the past. While facts may not change, our version of these facts certainly do. We all know and believe that market timing doesn't work, or at the very least isn't worth it. Yet, we continue to fret over small daily moves in the Dow Jones Industrial Average or the S&P 500 index and allow short-term events to dictate our long-term strategy.

Let's assume for a moment that the S&P 500 reaches its top for this year as you are reading this article — from today through the end of the year, the markets will trade lower than current levels. Should you sell? You might be quick to jump to a "yes" answer. But why? Does it really matter if the broader market vacillates or declines slightly in the short-term? In my view, the answer is no. It doesn't matter.

First have you considered taxes and transaction costs — either and both will lower your "real" return, so minimizing these is critical. Second, what about dividends, if you own a portfolio of high quality dividend-paying stocks, such as the ones found in our proprietary Dividend Buster Program, you'll be missing out on a quarter's worth of dividends, amounting to roughly to 1.25%. Furthermore, as we all know, the trick to market timing is getting both sides of the trade right, the sale and the purchase.

Let's assume for a moment that you got the sale right, but your timing was off on the buy side. Javier Estrada, a finance professor at the IESE Business School at the University of Navarra in Spain looked back at more than 160,000 daily returns from 15 international equity markets. He found that being out of the market during the 10 best days resulted in portfolios 50.8% less valuable than a passive investment.

Here's the bottom line: When you review your portfolio and make decisions regarding your investment allocation, you must take into account all of the facts. Consider transaction costs, taxes, and the possibility that you might be wrong.

One of the many reasons people work with a professional adviser is that it helps take the emotion out of the decision making process. Often, especially over the past five years, when I've spoken to a nervous client, I've been able to keep them from making costly mistakes.

My firm is as fallible as any other. We don't pretend to know everything. However, having a disciplined, consistent and replicable investment process will keep you from letting fear or greed get the best of you.

Oliver Pursche contributed to this article.

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