Ropes Wealth Reflects On the Pitfalls of Market Timing

Investors have enjoyed a strong week for markets, fueled by a rally in tech stocks, as Wall Street absorbed second-quarter results that in most cases were better than feared. A little bit of good news can go a long way when you have low expectations. Next week all focus will be on the Federal Reserve and their interest rate decision to be delivered on Wednesday. Expectations are for a seventy-five basis point interest rate increase, bringing the Fed Funds target interest rate range from 1.50%-1.75% up to 2.25%-2.50%. The Fed isn't the only central bank attempting to cool rampant inflation, on Thursday, the European Central Bank raised interest rates for the first time in 11 years by 0.50%.

As we digest earnings reports, interest rate decisions, and consider the future risk of recession, investors continue to grapple with the best course of action in these turbulent times. It is a natural instinct to seek to retreat or sell out of the market after a significant drawdown – locking in losses with a plan to re-enter when the market feels 'safer'. This behavior is driven by loss aversion – the desire to avoid additional losses because losses are so much more painful than gains are positive. The problem with the approach is the timing of knowing when to get back in, which is why most advisors will recommend staying investing through market turmoil and trying to maintain a long-term view.

In a recent conversation a client pushed me to explain why missing the worst days of market returns isn't as important as not missing the best days of market returns.

History has shown the best days to be in the market tend to occur very close to the worst days. Over 60% of the time, those best and worst days occur within two weeks of each other.

Consider the recent example during March 2020 as the early stages of the pandemic caused the market to decline -34% off its peak in a three-week period:

March 12, 2020: S&P 500 -9.49% for its second worst day in 20 years

March 13, 2020: S&P 500 +9.39% for its fourth best day in 20 years

March 16, 2020: S&P 500 -11.98%, its worst single day in 20 years

It is also worth noting that the S&P 500 rose 100% from March 23, 2020 through August 16, 2020 in the fastest bull market doubling off a bottom since World War II.

While we are certainly paying back some of those gains with the current market volatility of 2022, the clustering of the market's best and worst days, and best and worst periods of return, is an important reminder of how difficult market timing can be. Overall, the worst and best market days are just like rain and rainbows. Generally, a rainbow appears only after a thunderstorm. While intentions to miss the rain are valid, we will likely miss the rainbow that follows.

Markets tend to rise over time as they represent companies that continue to grow, innovate, and push forward our quality of life. Of course, there are some companies that do this better than others, and moments when we hit a pit stop or a price reset as we face challenges to our progress. As we all well know, the line of progress is never straight.

In 2016, Warren Buffet captured the phenomenon of human progress in an investor letter that resonates today: *"American GDP per capita is now about $56,000. In real terms – that's a staggering six times the amount in 1930, the year I was born, a leap far beyond the wildest dreams of my parents or their contemporaries. U.S. citizens are not intrinsically more intelligent today, nor do they work harder than did Americans in 1930. Rather, they work far more efficiently and thereby produce far more. This all-powerful trend is certain to continue: America's economic magic remains alive and well."*

American GDP per capita today is $69,288 as our progress continues.

As always, it is important to focus on what you can control in these volatile times: reserving the cash you need for short-term expenses, reviewing and ensuring your savings and spending plan is current and accurate, and maintaining a well-diversified asset allocation. By taking these steps, the instinct to try to time markets and indulge loss aversion will diminish as your confidence in your plan gives you the room to look forward and believe that progress will prevail.

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Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600