

Ships at Sea – An Essay on Market Timing

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I was looking into the crystal ball on my desk today to try and get a read on when the next big market downturn was going to occur. (Yes, there really is a crystal ball on my desk.) Wouldn't that be fantastic information to know ahead of time? Unfortunately the ball must be broken because it didn't tell me a thing.

We all like to imagine having the ability to forecast the market or be able to predict its movement. Think about it... how incredible would it have been if we had that ability back in March of 2000? Just imagine, having information *ahead of time* that told us that over the next three years we would see the S&P500 dip by more than 40%! Knowing that kind of information meant we could have moved all that money into cash and hibernated for three years while the Bears played. Seems logical that we'd be a lot better off today, right? Maybe not...

For most investors, they'd probably give back something near and dear to them for the opportunity to start over with their March 31st, 2000 account balances. Most investors, however, have no clue how to properly diversify an account and even less of an understanding of how capital markets really work.

It's obviously preposterous to know specific market information ahead of time like exact starting and ending dates of a Bear market. However, pick up any popular financial magazine or newspaper or click on any of the popular financial news networks and you will find general, as well as very specific, prognostications concerning the markets.

OK... so let's assume you picked up such a magazine in March of 2000. The cover of the magazine screamed at you to "SELL YOUR STOCK NOW!" and you decided that this was the magazine article that you were going to live your financial life by and you liquidated your stock portfolio based on the recommendations of the writer. Let's further assume that again in March of 2003, on the eve of the Bull run market, that same financial writer wrote, "OK, now it's over... GO BACK IN AND BUY NOW!"

So let's compare the results of the investor who had perfect market timing (or maybe just got lucky?) and sidestepped the whole 2000-2003 Bear market to the investor who just knew how to globally diversify, didn't have any advanced information about what markets were going to do and stayed invested the whole time.

Who would have had more money on 6/30/2007? Seems like a no-brainer, doesn't it? The market timer should win, right?

Let's see... assume your buddy is the market timer and he liquidated his \$100,000 portfolio in March of 2000. He waited on the sidelines until March 31st, 2003 and then invested it into the S&P 500 until June 30th, 2007. His \$100,000 would have grown to \$191,440 and he would have sidestepped one of the worst Bear markets anyone can remember.

Now for comparison, let's assume *your* \$100,000 was invested in a well-diversified account that consisted of 60% stocks and 40% fixed income (a "normally" balanced account) and you never liquidated it because you have the discipline not to follow the advice of financial magazines. How would your portfolio have performed?

Your diversified portfolio would be worth \$195,600, or over \$4,000 more on June 30th, 2007!

You see, with a properly diversified account that focuses on global asset classes you avoided the steep losses that the US stock market delivered from March 31st, 2000 to March 31st 2003. Then when US markets turned in April of 2003 the globally diversified portfolio was right there to capture those returns... from the first day. No guessing, no concerns about missing a critical issue of MONEY magazine or renewing a subscription to the Wall Street Journal. No trying to pick the guru du jour.

So where are we at today? What will the markets do over the remaining months of the year?

If you are in for the long-haul, does it really matter?

The real question right now is, does your portfolio conform to Modern Portfolio Theory and is it prepared for another market downturn if it were to come soon? Are you properly diversified across global asset classes to give your portfolio every advantage the academic community has taught us about risk and capturing returns from capital markets?

We've had a nice Bull run and as nice runs go, this one has lasted a while. Over the last 4 years a diversified account has been important to capture the aggressive returns of US and International Small Cap stocks, value stocks and emerging market stocks. But what if markets become more volatile and we see another repeat of 2000 – 2003? Won't diversification be even more important?

Time and time again we've seen that staying invested, keeping your ships at sea, even when what looks like a severe market downturn is taking place, is the right thing to do... just as the example above illustrates.

If you are a Northstar client, rest assured that your portfolio is allocated across global asset classes. If you are not a Northstar client and happen to be reading this... what are you waiting for? Call us and set an appointment to review your portfolio. It may be the best thing you have ever done for your portfolio and your future financial security.

The globally diversified portfolio and allocations used in this article consisted of the following: DFA US Large Company Portfolio 12%, DFA US Large Cap Value Portfolio 12%, DFA US Small Cap Portfolio 6%, DFA US Small Cap Value Portfolio 6%, DFA Real Estate Securities Portfolio 6%, DFA Int'l Value Portfolio 6%, DFA Int'l Small co. Portfolio 3%, Int'l Small Cap value Portfolio 3%, DFA Emerging Markets Portfolio 1.8%, DFA Emerging Mkts Value Portfolio 1.8%, DFA Emerging Mkts Small Cap Portfolio 2.4%, DFA 1-Yr Fixed Income Portfolio 10%, DFA 2-Yr Global Fixed Income Portfolio 10%, DFA 5-Yr Govt. Portfolio 10%, & DFA 5-Yr Global Fixed Income Portfolio 10%. The portfolio was balanced back to its original allocation percentages each quarter. Performance figures do not reflect the deduction of investment advisory fees. Returns would be reduced by advisory fees and other expenses that may be incurred in the management of the investment advisory account. Investment Advisory Fees from Northstar Financial Planners, Inc. are described in Part II of the Form ADV, available upon request.