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Time In the Market is Critical for Investment Success

Investing is about managing the risks that will substantially reduce your ability to "stay in the game long enough" to "win."

Lance Roberts

The first reality of investing is that financial markets are volatile.

Since 1950, there have been 11 bear markets when the S&P 500 Index lost 20% or more of its value. It took 13 years for the index to recover from the consecutive bear markets that began in March 2000 and October 2007 and begin making gains again.

The second reality is that it is hard to outperform the buy-and-hold return of the S&P 500 index.

Investors have typically been rewarded over the long term for their willingness to accept the risk and volatility of the market by performance that few investment managers exceed.

So why not just invest in a S&P 500 index fund and walk away for the next 20-30 years? After all, Warren Buffett's recommended portfolio for individual investors is 90% in a S&P 500 index fund and 10% in a low-cost, short-term U.S. government bond index fund held for the long term.

The problem is that no one knows how much will be lost in a market decline, how long the decline will last or how much time it will take to recover. Every bear market takes place in unique circumstances. There are no guarantees that the magnitude of the next decline or time to recover will reflect past downturns. Nor can there be any assurance that one's portfolio will have recovered by the time the investor needs the funds.

The memory of the crash of 2000 when an estimated $8 trillion of wealth was lost is still very fresh in investors' memories. The market had barely returned to its 2000 highs in 2007 when a second jolt sent it down 42% before the end of 2008. Most recent was the Coronavirus Crash, 33 devastating days from Feb. 12 to March 23, 2020 when the S&P 500 fell 34%.

It doesn't matter how great a portfolio might perform over the long run if the investor is unable to stay the course during bear markets. Real people tend to sell when markets collapse and then hesitate to re-enter the market until they have missed much of the recovery. It's not that they are stupid. It's that they don't have sufficient funds that they can afford to wait a decade to recover.

It's easy to sit out a market crash with a $1 billion diversified portfolio and no immediate need for the full $1 billion. Watching a $500,000 retirement portfolio whittled down to $300,000 can be devastating. There are no guarantees that the portfolio will recover in time to meet your retirement needs. If you need to withdraw from the portfolio to meet living costs following a bear market loss, in many prior market declines you would never have recovered from the loss and run out of money much too soon.

The quote at the start of this article summarizes Investing in a nutshell. The investor has to "stay in the game long enough" to "win." That means managing the risk of major portfolio drawdowns and making certain the investor has the funds they need, when they need them. There is a cost to limiting risk. Less risk typically means less opportunity for gains over the long run. Over the short run, limiting risk may outperform market return. Miss a substantial part of a bear market, and you have more money to invest when the market turns back up. That may be enough to counteract the cost of missing an early part of the rebound.

For your investment portfolio to succeed, you have to be in for the long run. That requires an investment approach that limits risk to a level that makes sense for your financial situation. While there can never be a guarantee that an investment approach will be successful, buy-and-hold investing comes with the reality that your portfolio can lose substantial value in a market downturn with no guarantees of how long it will take to recover or if you will recover.

If you are uneasy about your investments in today's tumultuous environment, schedule an appointment with your investment advisor and make certain you understand your risk exposure, how your advisor will strive to protect your portfolio in the event of a market decline and if you have the confidence to "stay in the game long enough" to "win."

All investments and investment strategies have the potential for loss as well as gain. Past performance is no guarantee of future returns. Information in this article is not intended as investment advice, but rather to provide a better understanding of investment principles.

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