

## Investment Update – April 2006

We have enjoyed three rollicking good years of stockmarket performance. Those clients with an exposure to stockmarkets have shared in these returns. But what to do now? Invest more in equities? Move out of the stockmarket and into cash?



Longstanding clients will know that our default position is that you should rebalance your portfolio as agreed with your adviser. For those with impending reviews that possibly means taking some profits on equities to re-establish the asset allocation previously agreed.

Stock tip sheets and the press are however full of advice about whether the market looks expensive or cheap. [Of course there is no consensus that the market is either over or under valued because if there was such a consensus then prices would adjust and there wouldn't be a consensus that the market was incorrectly valued but that's another article].

Many investors believe market timing is critical to investment returns. It would be very nice to time one's investments to avoid the bad days or years and this is very easy to do with the benefit of hindsight. The tricky bit is getting the timing right without hindsight.

A dispassionate look at the statistics suggests that market timing does not work and actually increases risk. We have consistently argued that equity investment must be a long term strategy.

Imagine three investors – Disastrous David (DD), Boring Ben (BB) and Clever Kevin (CK). DD invests every year for 35 years and gets it completely wrong every year – always buys at that year's peak. BB just buys on the 1 January every year regardless. CK invests every year for 35 years and gets it spot on every year – always buys at the bottom of the market.

Here are the annual returns they achieved to 31 December 2005:-

Market	DD	BB	CK
UK	13.1%	13.8%	14.3%
US	11.7%	11.9%	12.6%

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The differences between the returns are fairly small considering the appalling luck of David and the brilliant timing of Kevin. Now over the 35 years we are examining a fundamentally rising market and there are shorter periods where David really suffers and Kevin enjoys the high life – but over the long term these differences shrink.



Stockmarkets move in fits and starts – I wrote about this in a previous note. The risk that both David and Kevin took was of missing sharp upward moves. There are many years where only one month enjoys good performance.

Here are some statistics showing the effect of missing the best 10 days over 10 years and missing the best 40 days over 10 years. Figures are annual returns and the data covers 10-year periods between 1990 and 2006 – i.e. 10 year periods beginning between 1990 and 1996.

Market	Stay invested	Miss best 10 days	Miss best 40 days (only 4 per year)
UK	10.8%	7.6%	1.7%
US	11.5%	8.1%	1.1%

It is also perversely easier to miss sharp upward moves than sharp downward moves - quite often the best days are the days just before or after a big drop.

Analyses such as this have been repeated many times and have been in the public domain for years. Many retail investors however continue to concentrate on market timing. We believe this will on average detract from rather than increase returns. We conclude that market timing increases rather than reduces risk. It also increases costs. We recommend against it and recommend remaining invested in line with your plan for the very long term – ten or twenty years.

Thanks to Fidelity and Dimensional who assisted with the above.

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**If you would like a fresh perspective on your financial position from genuinely independent professionals please contact Ben Sherwood on 01442 220713 or [ben.sherwood@hhllp.co.uk](mailto:ben.sherwood@hhllp.co.uk)**

For more information on any of the issues raised your current Hillier Hopkins contact will be happy to assist you. Alternatively, please call us on 01442 220788 to speak to one of our advisers.

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