Important Question: What Are You Trying to Achieve?

By Brandon Snow, Principal and Chief Investment Officer
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One of the most important questions in an investment process – whether you're viewing it from an asset allocation, position sizing or stock picking perspective – must be: what are you trying to achieve?

Every investment decision needs a plan because it's too easy to exchange your hard-earned money to buy a stock (or index, or a fund). What are your investment goals? How long do you plan on investing? What other investments do you already have? What is your risk tolerance? Without a solid understanding of your long-term financial goals and subsequent plan, you could end up putting your capital to work without an understanding of how those investments are helping you achieve your goals; that is, whether they are generating appropriate returns to meet your goals, or even when you should buy more of a stock or fund or exit your position in them entirely.

This brings me to one of the most perplexing and frustrating investor mistakes: market timing. This phenomenon happens both in strong momentum markets and during deep downturns, but it seems to be much more acute after sell-offs.

A portfolio manager I worked with in the past used to say (I am paraphrasing), "Why should I time the market when I don't know the future? I have a 50% chance I am getting out at the right time, but I also have to get in, so that's another 50% chance I get back in at the right time. That adds up to a low chance of getting it right."

While this is a great point, it's not a complete thought. Let's think through this in more detail.

The first question you should ask yourself is: *Am I an investor or a speculator?* The 'father of value investing,' Benjamin Graham, once said, "An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."

To spell it out, are you trying to participate in the value creation a company can deliver, hoping to enhance that by buying below the company's intrinsic value, or are you speculating on prices, hoping what you are paying for a security will be below what someone else will be willing to pay in the future? This is an important distinction since it will help you understand your time horizon. If you sell (or buy) today, when are you expecting to buy back (or sell) in the future? This question is also important because both the probability and magnitude of positive versus negative returns are dependent on the time-frame you use (see table below).

Probability of Positive and Negative Returns

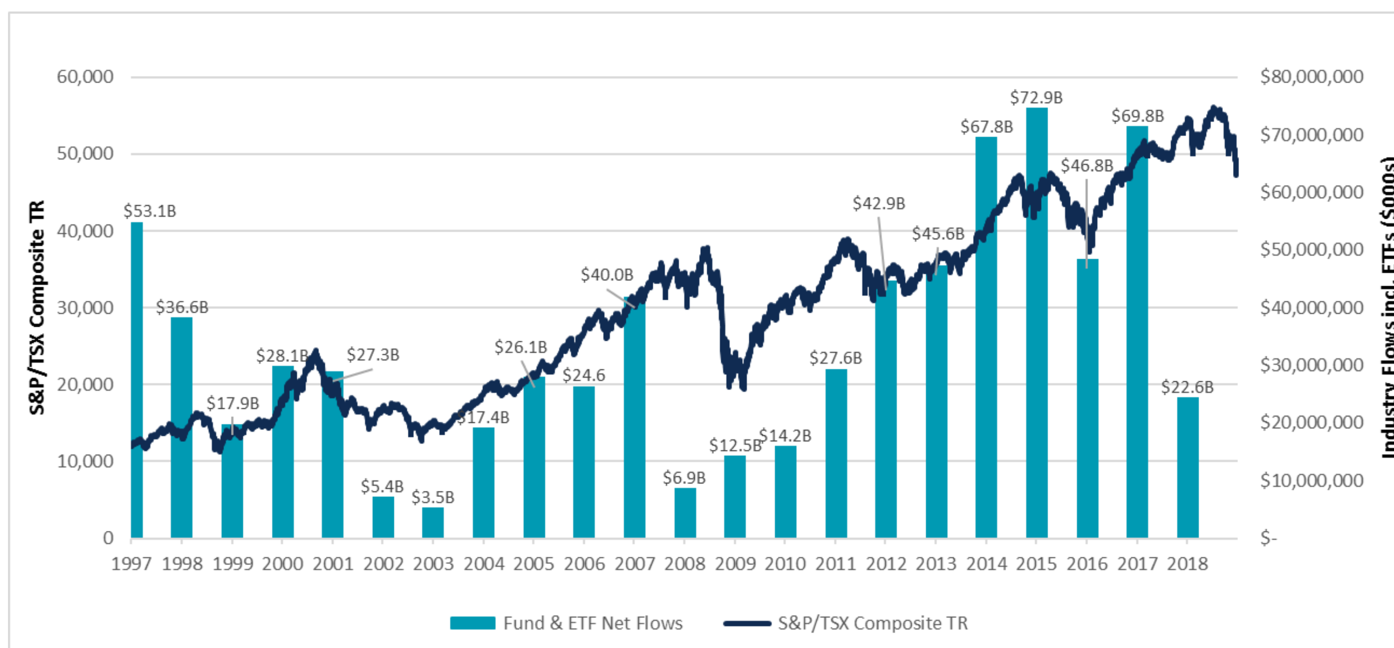
	Daily	Weekly	Monthly	Quarterly	Yearly
Probability of positive return	53.6%	57.2%	62.6%	68.2%	78.8%
Probability of negative return	46.4%	42.8%	37.4%	31.8%	21.2%
Average Positive Return	0.73%	1.57%	3.05%	5.62%	15.32%
Average Negative Return	-0.77%	-1.72%	-3.36%	-5.76%	-15.62%
Expected return	0.03%	0.17%	0.65%	2.00%	8.77%
	Over period 12/31/1991 to 5/3/2019				

Source: S&P 500 Index Price Return (trailing), May 6, 2019.

Both trading costs and tax implications need to be considered when choosing your time horizon. To maximize after tax returns (assuming a taxable account), your holding period should be a minimum of one year. As you can see above, nearly 80% of the time the returns over a year are positive.

Given the high probability of positive returns over the long term, an investor should consider several characteristics of what type of investment to buy, including a fund's long-term (not short-term) record, fee structure, consistency to the investment process and the management team.

Regardless of the investment selected, investors should then ask themselves: "How good am I at timing the market?" How would your return be impacted if you were the average investor? What if you are really good? How about ridiculously good? Can you get it right at least 80% of the time to enhance your long-term return? This is difficult to imagine. The reality is much worse (see chart below).

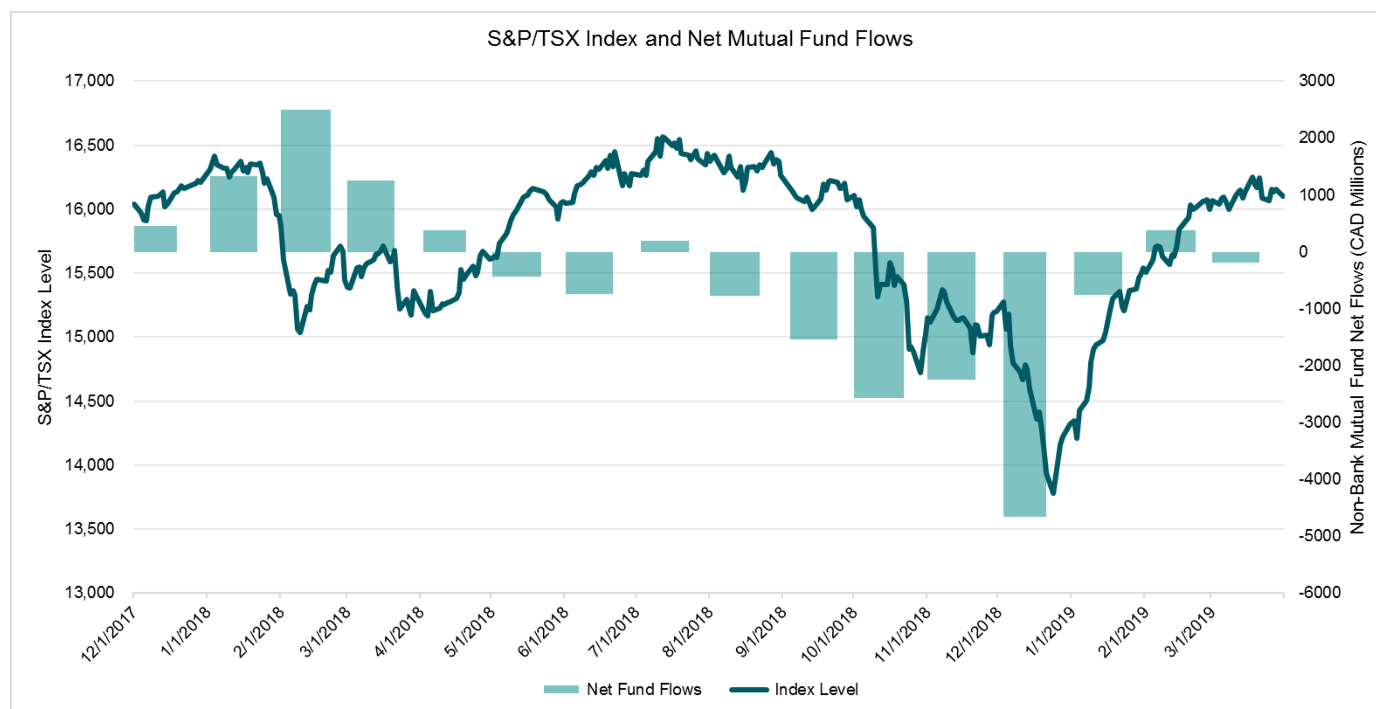


Sources: Strategic Insight, Bloomberg Finance L.P. and CI Investments Inc. Industry flow data represents all Canadian market mutual fund flows as at November 30, 2018. The S&P/TSX Composite Index data is as at December 31, 2018.

History teaches us the importance of staying invested in good times and bad – and, if appropriate, adding good investments to the portfolio when prices are down.

Yet, time and again, we can see the attempt to sell, then buy back one's market exposure is not only a low probability but also has a negative expected return. This is probably one of the biggest mistakes an investor can make: to be blinded by damaging emotions that have a negative impact on your investment portfolio.

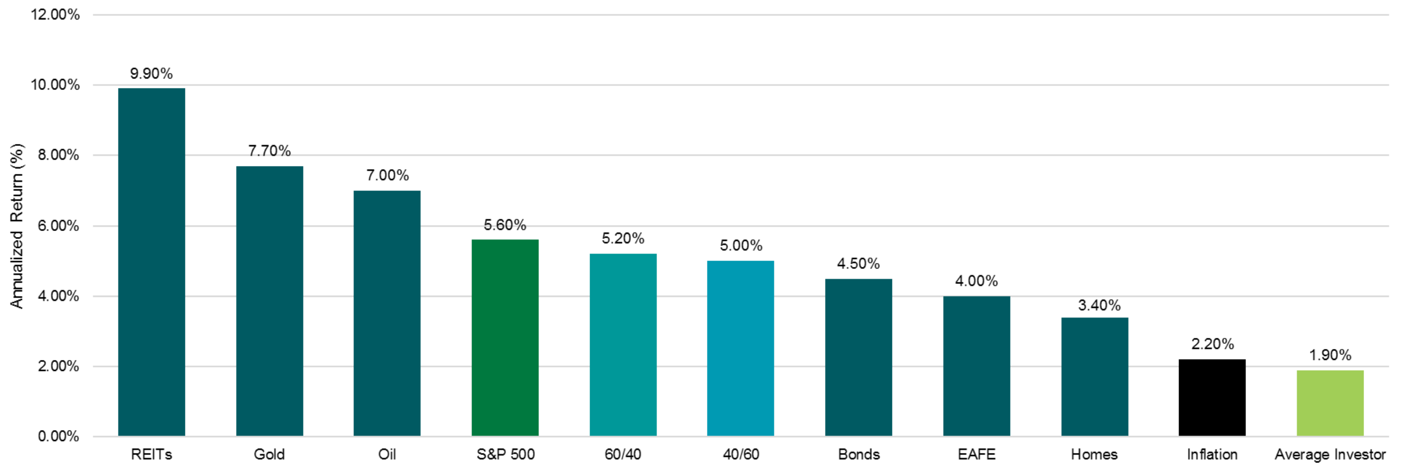
Following is further data showing volatility since December 2017:



Sources: Strategic Insight and Bloomberg L.P. (Note: Fund Flows represents flows for non-bank Canadian market mutual funds.) Retrieved May 13, 2019.

From the above chart, one can see that investors are consistently pulling money out of the market after a decline and buying after the advance. While it may be possible over short periods of time to predict the market, it is more difficult to be consistent and to accurately predict the market over the long term. Not only are investors overconfident about their ability to actively manage their money, but they are also taking on bad bets and really, really bad at investing.

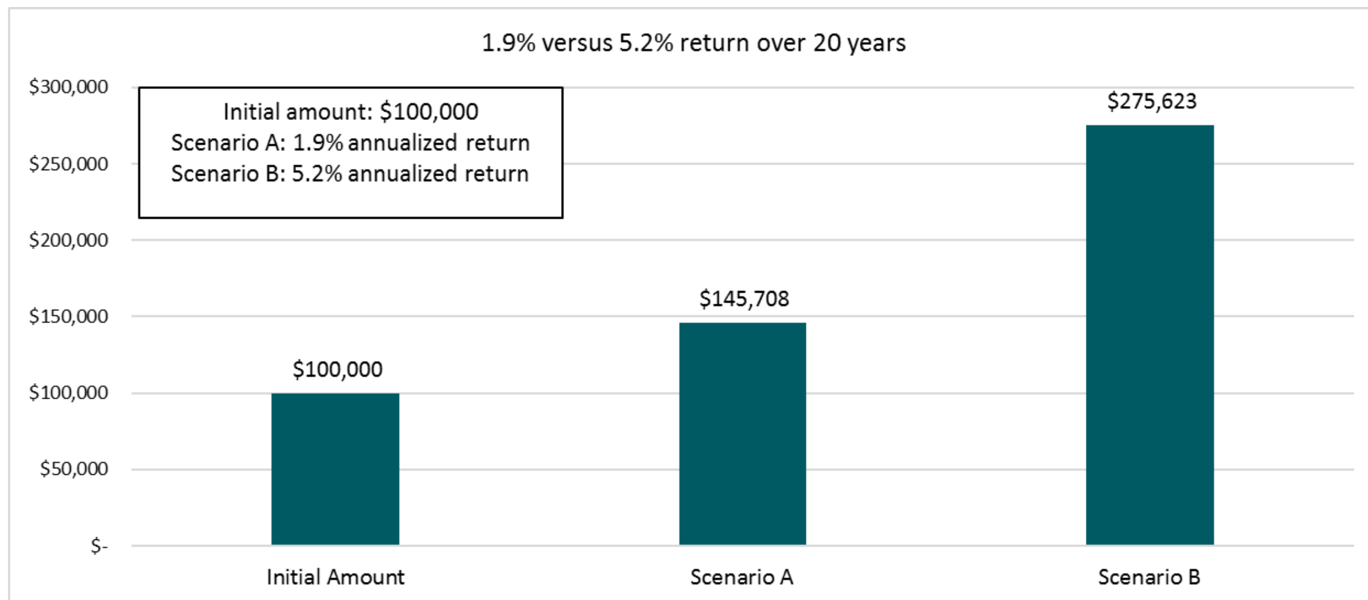
The impact has been devastating to wealth returns for the average investor (see chart below).



Sources: J.P. Morgan Asset Management; (Top Chart) Barclays, Bloomberg L.P., FactSet and Standard & Poor's; (Bottom Chart) Dalbar Inc., as at March 31, 2019.

Indices used are as follows: REITs, NAREIT Equity REIT Index; EAFE, MSCI EAFE Index; Oil, WTI Index; Bonds, Bloomberg Barclays U.S. Aggregate Index; Homes, median sale price of existing single-family homes; Gold, USD/troy oz.; Inflation, CPI. 60/40 is a balanced portfolio with 60% invested in the S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate U.S. market mutual fund sales, redemptions and exchanges each month as a measure of investor behaviour. Returns are annualized (and total return where applicable) and represent the 20-year period ending December 31, 2018, to match Dalbar's most recent analysis.

Putting this into dollars and cents (so it can really sink in) is the chart below.



For illustrative purposes only.

Are sell-offs scary? YES.

Are they worse when you are a passenger and not the driver of your investments? ABSOLUTELY.

Does the media add to the anxiety by sensationalizing market moves, with the goal being to generate ad revenue? OF COURSE!

Try to tune out the short-term market movements. While you should always stay on top of your investments, markets rise and fall for a variety of reasons that are not always what the headlines say. And while news could be used as information, it should not be correlated with investment decisions.

Remember that we have the free will to do nothing. We are free to ignore the noise. And free to consistently remind ourselves that over the long run, stocks go up. Ignore the short-term noise and focus on attaining long-term goals. Maybe, keep that last chart around to help you be focused for the long run, and ask yourself whether a short-term drop in the value of your portfolio is going to matter to you by the time you retire in 10, 20 or 30 years.

Investing without emotion is easier said than done, but there are some important considerations that can keep an individual investor from chasing futile gains or overselling in panic. While losses are part of the deal when investing in stocks, how you react to those losses is one of the biggest determinants of your investment performance.

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So, the next time you are trying to time the market, resist the temptation to fall into typical investor traps and overcome your emotions by developing a long-term investment plan, which starts off by asking yourself: ***What are you trying to achieve?***

Brandon Snow

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