When is the Right Time?

By Gil Hanoch, October 7, 2005

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If you are familiar with my previous articles, you can guess that this article is not going to discuss predicting when certain stocks will go up. Multiple research projects have shown that most people who time their stock purchases do worse than people who buy a diversified portfolio and stick to it.

This article will propose a timeline for adding new money into your stock portfolio. Several cases that you might encounter during your lifetime are:

1. Depositing money into your retirement accounts.
2. Adding spare income into your regular investment account.
3. Receiving a windfall including inheritance, lottery winnings or other large amounts.

The discussion in the article will be limited as follows:

1. **When is the money needed?** A stock portfolio should be limited to long-term investments. If you need the money in the next few years, the answer to "when is the right time?" is "never". Every investor should use a written plan that finds the right balance between short-term security and long-term security. Maintaining solid short-term security at all times is the basis to any investment in the stock markets.
2. **How is the money going to be invested?** The more diversified your portfolio, the less volatile it should be, and the more money you can afford to put into it. This article assumes a globally diversified portfolio that avoids market timing and individual stock selection (e.g., Long-Term Component by QAM). In other cases you are facing significant additional risks.

Under these assumptions, the answer is simply: add the money as soon as it is available!

The answer follows from a combination of reasons:

1. **Stock markets statistically grow**. If history is any indication of the future, your money is more likely to grow than decline in any given period.
2. **We don't know what the stock market will do in the short-term**. At certain times, the stock market seems highly overvalued, and you expect it to crash any day. The problem is that you cannot predict reliably when or if it will happen. If you think you can, try to remember if you said in March 2000 – not earlier and not later – "This is the peak, I should sell now!" If you were one of the few that did, ask yourself if you want to bet your money on predicting it again.

How should you add the money in different cases? We can bring this down to a pretty exact science, with individual treatment for each case:

1. **Depositing money into your retirement accounts, up to an annual cap**.
   a. Ideally, you would want to deposit your full paycheck into your retirement account, until you have reached the annual cap. You can simply ask your employer to allocate 100% of your salary to your retirement account, after you verify that the deductions will automatically stop as soon as you reach the annual cap.
   b. If you cannot afford contributing the legal limit, you would have to change the allocation to 0% as soon as you reach your limit.
   c. If you are self-employed, you can deposit the full amount on January 1st!

Note that the result is equivalent to enjoying an increased limit on the retirement deposits!

Also note that you may need to spread the deposits over time to leave money for daily living expenses. The timeline above is the ideal one assuming no such restriction.

2. **Adding spare income into your regular investment account**. Ideally you would add the money as soon as it is available. An exception is when you expect to have another deposit before your first addition grew to cover the transaction cost. The minimal time gap could be estimated as: transaction-cost / amount-to-deposit / (percent-average-annual-growth / 100).

   For example, if you want to add $2,000 into QAM's portfolio, you should wait if other amounts are available within the next: $24 / $2,000 / (17.2 / 100) = 0.07 years = 25 days.

   Please note that this is a rough estimate that ignores compounding of growth and the fact that amounts can bear interest while waiting for investment; both would increase the resulting period. If you are QAM's client, this calculation can be done for you when needed.

   Full proof of the formula and the exact version are available upon request.

3. **Receiving a windfall including inheritance, lottery winnings or other large amounts**. In all these cases you receive a large amount of money, and the thought of a severe market decline right after you invested it may be painful for you. Because it is more likely that the portfolio will go up, the recommendation to invest the total amount at once still applies. Even if the portfolio severely declines right after you deposit the money, it is just a matter of time until it recovers and goes much higher. Gambling against stock markets going up is very risky business and you are statistically more likely to lose than win.

How can you use the announcements about "sales" of the portfolio?

The article, "Celebrating the Gloomy Days" (Hanoch, February 2005) demonstrated two things:

1. Statistically, after severe declines, you are more likely to see larger than average gains.
2. History shows that no past pattern presents increased likelihood for declines, not even recent extreme growth.

QAM's monthly client emails announce "sales", which are declines in the portfolio. Normally you should invest all of the amounts that you designate for long-term investments immediately. In cases where you haven't done it for whatever reason, this can be used to remind you to act soon after the announcement came out and to potentially experience larger than average gains.

Please remember that the opposite is not true! You cannot predict when a portfolio will decline based on past statistics. Therefore, you should not wait to deposit an amount because there was no sale announcement in the most recent email, or because the portfolio increased extraordinarily recently. It may continue for years before a decline will occur, or the portfolio may simply increase more slowly for a while, never declining below the current level.

To summarize

If you are holding a globally diversified portfolio with no individual stock selection or market timing, and you have money available for long-term investments, large enough to justify the transaction costs, it is usually best to add it all at once with no delay.

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