

Quality Asset Management

Grow Your Wealth with Peace of Mind

When Should you Re-Enter the Market?

By Gil Hanoch, December, 2009

If you sold stocks during the 2008 decline in an attempt to avoid the worst of it, you are facing the question: "When should I reinvest the money in stocks". The common answer I hear is: "When things look better". There are certain difficulties in implementing this solution.

The following progression explains these difficulties:

1. Since the stock market tends to precede the economy by 6-12 months, it tends to begin its recovery well before the economic recovery. By the time things look better, the stock market has often already gone through the initial part of the recovery.
2. The initial recovery tends to be substantial and proportional to the size of the decline. For example, after the portfolio Long-Term Component reached a bottom of the severe decline in March 2008, it went up 50% in 3 months.
3. After such substantial gains, you may feel that a decline is likely. This can be exaggerated by an economy that is not fully recovered yet. Buying after a substantial gain right before a decline would make you feel like a fool, so you'd rather wait for the decline to occur before investing. When doing so, you risk missing an even greater portion of the gains.
4. The longer the gains go, the worse you feel, and the more it seems like a decline will come. The greater the gains, the greater the decline you expect. As the gains mount, you are not moved by a 5%-10% decline – you keep waiting for a greater correction. Your portfolio can go up higher and higher for years, before you see the anticipated decline. In this case, it took a mere 7 months for the portfolio to go up 100% from the bottom.
5. After a number of years, and gains of well over 100%, you realize that the decline is not coming, and you finally invest your cash.
6. By the time you reinvested, you may buy at a price higher than what you sold for during the past decline. You would have been better off never selling in an attempt to avoid the decline.
7. Looking forward, by the time you reinvested, your portfolio may come closer to the next decline. Any moderate decline may make you think that this is the beginning of the big correction you were waiting for, leading you to sell. If you do so, you may sell at a price lower than your purchase. Again this leads you to underperform your own portfolio, and you would have been better off not selling at all.

Every item on this list reflects thoughts expressed to me by investors – it is not a hypothetical list. Please think about the 2008 decline, and see if you identify any of these patterns in your thinking. It is very natural to think this way; what differentiates successful investors from unsuccessful ones is whether they act on these thoughts.

Summary

Our brain guides us to expect certain patterns in the stock market, as well as changes that respond to economic events with a time lag. These expectations lead us to behavior that can hurt our long-term performance. Because the stock market is unpredictable, and it changes instantaneously in response to changes in the economy, your best bet is to accept your long-term portfolio returns in good and in bad, and to stay invested for the long term. The total returns for stocks are very impressive, and taking them as a whole is the most conservative and prudent approach to stock investing.

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