AMI INVESTMENT MANAGEMENT
Registered Investment Advisor

Memo to: Clients and Contacts
From: AMI Investment Committee
Re: Timing Markets
Date: November, 2015

"I am clear that the idea of wholesale shifts is for various reasons impracticable and indeed undesirable. Most of those who attempt it sell to late and buy too late, and do both too often, incurring heavy expenses and developing too unsettled and speculative a state of mind." – John Maynard Keynes[1]

"We've long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children." – Warren Buffett[2]

"[If investors] insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy only when others are fearful." – Warren Buffett[3]

Investment theory strongly predicts that stocks should have higher long-term returns than bonds, on account of greater short-term risk. Experience has supported theory. From 1950 through 2014, U.S. stocks returned 11.4% per year versus just 6.4% for U.S. government bonds.[4] But stocks also go through much more painful short-term periods, falling 20% or more on regular occasions. Can't investors learn how to time the markets to enjoy the gains but avoid the pain?

The short answer is no. We've seen no consistent, reliable method to engage in such behavior successfully. There is an old saying: "There are old pilots and there are bold pilots, but there are no old, bold pilots." The same could be said about those who try to time the market by jumping in and out of stocks. During most periods, the best we can say is that stocks are priced in a "range of fair value." They may be a little on the high side at times and a little on the low side other times, but usually the best an investor can predict is that longer-term, stock returns will outpace bond returns. The best course of action for the vast majority of investors is to determine a mix of stocks and bonds that is right for their specific situation and stick to it through thick and thin (assuming their situation doesn't change).

In some select circumstances, stocks may become so cheap or so expensive that the enterprising investor might consider temporary changes to his long-term stock/bond mix. But success requires the grit and independence to go against the herd. Stocks are expensive during periods of euphoria, such as the dot-com boom of the late 1990s. They are cheap during periods of crisis, such as the great recession of 2008-09. Few have the temperament to sell during the former and

[1] Memorandum for the Estates Committee, King's College, Cambridge, May 8, 1938.
[2] Berkshire Hathaway 1992 shareholder letter.
[3] Berkshire Hathaway 2004 shareholder letter.
[4] As measured by the S&P 500 and the Ibbotson Intermediate Term Government Bonds from 1950-1993 and the Citigroup 1-10 Year Government Bonds from 1994-2014.

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buy during the ladder. Those who do should insist that stock valuation are well outside of defensible levels relative to both history and competing classes of investments.

Unfortunately, most end up doing the opposite – buying more stocks after a great advance in the market or selling at the bottom – which comes at a great cost to their long-term results. An analysis by Dalbar and Lipper found that the average investor in stock mutual funds cost himself *4.7% per year* during the period 1992 through 2011, mostly as a result of chasing hot areas of the market and running away from weak ones.[5] This is a huge penalty.

Accordingly, the best course of action is to focus on the long-term, stick to a planned mix between stocks and bonds, and tune out the short-term noise. Financial commentators and talking heads love to scream "sell, sell, sell" or "buy, buy, buy" because they make money off of activity. But the patient, disciplined long-term investor comes out ahead in the end.

[5] Davis Advisors. "Avoid Self-Destructive Investor Behavior." Corporate pamphlet, undated. Citing *Quantitative Analysis of Investor Behavior* by Dalbar, Inc. and Lipper. March 2012.

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