The Market Has No Memory

Oakwood is now in the second decade of its partnership with Dimensional Fund Advisors (Dimensional). This partnership has provided us with access to all of the institutional funds offered by Dimensional, and has allowed Oakwood to construct and customize globally diversified portfolios for our clients.

Our Monthly View for February is an edited version of an article written by David Booth, Executive Chairman and Founder of Dimensional, supplemented with additional data from another Dimensional article entitled "What Happens When You Fail at Market Timing".

David Booth discusses the lessons from 2019 that investors can apply to 2020:

I have worked in finance for over 50 years, and it seems that every January the same thing happens. Lots of folks look back at the prior year's performance to draw conclusions they can use to predict what markets will do in the year to come. I do not make predictions, but I do think it is helpful to answer this question: What are the lessons from 2019 that we can apply to 2020?

Let's go back to where we were after the end of 2018. The words running across CNBC's home page were, "U.S. stocks post worst year in a decade as the S&P 500 falls more than 6% in 2018." The Wall Street Journal summarized the state of market affairs with this headline: "U.S. Indexes Close with Worst Yearly Losses Since 2008."

We started the 2019 year with a lot of anxious people. Some decided to get out of the market and wait for prices to go down. They thought that after 11 years, the bull market was finally on its way out. They decided to time the market.

We all know what happened. Global stock markets finished the year up more than 25% (MSCI World Index) and global bond markets gained more than 8% (Bloomberg Barclays Global Aggregate Bond Index).

Missing out on big growth has as much impact on a portfolio as losing that amount. How long does it take to make that kind of loss back? How is someone who got out supposed to know when to get back in? What happens when you fail at market timing?

Well, the impact of missing just a few of the market's best days can be profound, as shown in this look at a hypothetical investment in the stocks that make up the S&P 500 Index. The table shows that a hypothetical $1,000 investment turned into $138,908 from the beginning of January 1970 through the end of August 2019. Miss the S&P 500's five best days and you have $90,171. Miss the 25 best days and the value goes down to $32,763.

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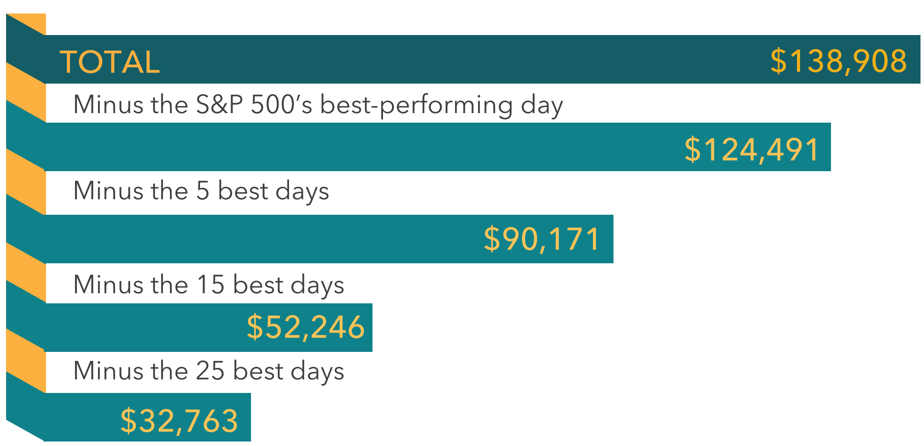
Hypothetical Growth of $1,000

Invested in U.S. Stocks in 1970



Based on the total return of the S&P 500 from Jan. 1, 1970 to Aug. 31, 2019. Performance data for January 1970 – August 2008 provided by CRSP; performance data for September 2008 – August 2019 provided by Bloomberg. S&P data provided by Standard & Poor's Index Services Group. Indices are not available for direct investment. Past performance is no guarantee of future results.

Source: Dimensional Fund Advisors

There is no proven way to time the market – targeting the best days or moving to the sidelines to avoid the worst – so history argues for staying put through good times and bad. Investing for the long term helps to ensure that you are in position to capture what the market has to offer.

The lesson from 2019 is: The market has no memory. Do not time the market in 2020. Do not try to figure out when to get in and when to get out – you would have to be right twice. Instead, figure out how much of your portfolio you are comfortable investing in stocks over the long term so you can capture the ups and ride out the downs.

Not enough "experts" subscribe to this point of view. They are still trying to predict the future. You have probably heard the saying, "The definition of insanity is doing the same thing over and over again and expecting a different result." I have seen people make this same mistake for 50 years.

We will never know when the best time to get into the market is, because we cannot predict the future. And if you think about it, that makes sense. If the market is doing its job, prices ought to be set at a level where you experience anxiety. It is unrealistic to think the market would ever offer an obvious time to "get in." If it did, there would be no risk and no reward.

So, what should you do in 2020? Keep in mind the most important lesson from 2019, which is the same lesson from every year before: Continue to be a long-term investor in a broadly diversified portfolio. Reduce your anxiety by accepting the market's inevitable ups and downs. Stop trying to time the markets, and you will find you have more time to do those things you love to do.

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