Investment Lab – Portfolio Strategy

The Cost of Cashing Out

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When markets become volatile, it can be tempting to try to 'time the market' or wait for a clear recovery. However, history shows that investing in this manner can lead to long-term underperformance compared to a strategy of remaining invested.

Staying resolute to a plan

A key principle of investing is staying resolute to a robust investment strategy, rather than reacting to short-term swings in the prices of financial assets.

Financial markets can at times be volatile and this can lead to uncertainty over the direction of prices, which may lead some investors to consider deviating from their long-term investment strategy. However, the best days in markets often occur close to the worst, and so doing so could be detrimental to building long-term wealth.

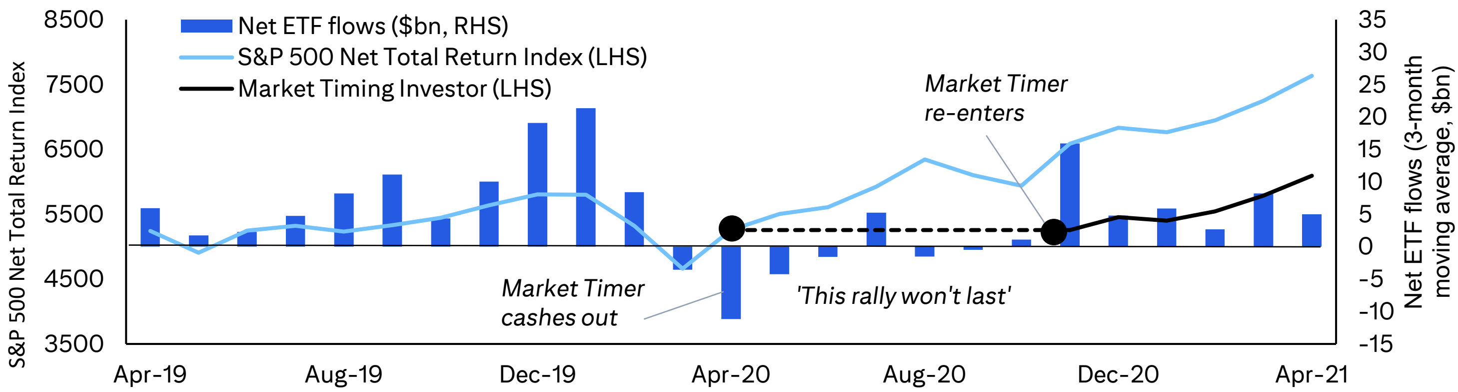
Timing the market is unlikely to work

When markets are volatile, it can be tempting to try to 'time the market'. However, this approach can be costly in terms of performance.

The chart below shows the behaviour of S&P 500 Exchange Traded Fund ('ETF') investors during the Covid-19 selloff in 2020. The strongest selling (outflows) in ETFs only occurred around the time the S&P 500 was finding its lows. The strongest buying (inflows) following this occurred only after significant gains had already occurred, suggesting that many of those who left the market re-entered but 'too late' and missed out on positive returns that they would have enjoyed had they stayed invested.

This pattern of getting both out of the market too late and getting back in too late is common during down markets, but is likely a recipe for long-term underperformance[1].

S&P 500 returns and ETF flows at the start of Covid-19



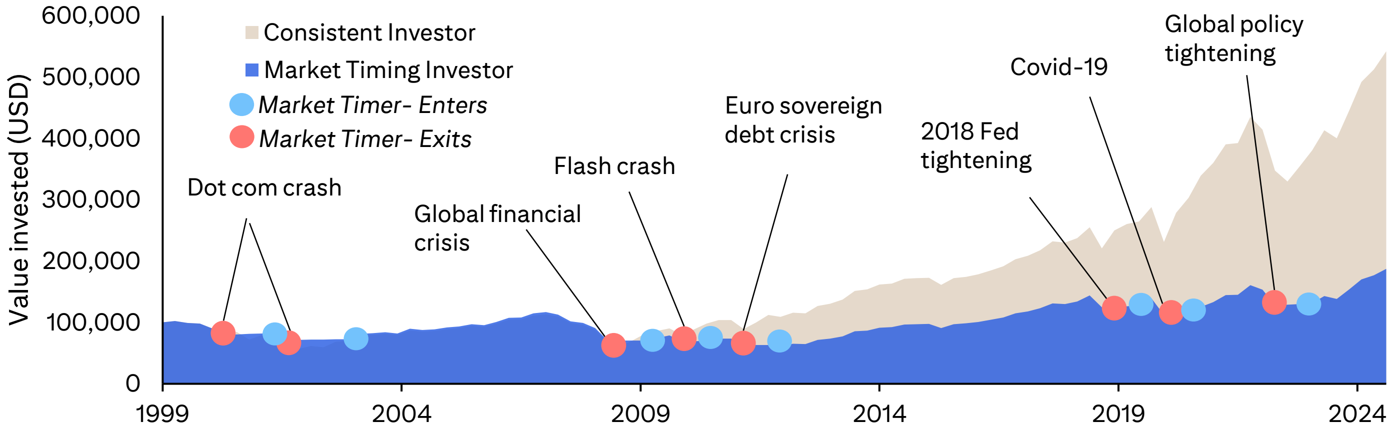
Source: Citi Wealth Investment Lab, Bloomberg. Data from 1 April 2019 to 30 April 2021. [1]The black solid and dotted line above shows the returns from cashing out of the S&P 500 Net Total Return Index at the date of the greatest ETF outflows (April 2020) and reinvesting at the date of the greatest ETF inflows during the subsequent rally (November 2020).

Trying to "time" the S&P 500 Index

We show this by examining the hypothetical performance of a 'Consistent Investor' and a 'Market Timer' who each invest a hypothetical $100,000 into the S&P 500 index on 31st December 1999, near the peak of the dotcom bubble. The Consistent Investor then simply stays invested. The Market Timer sells entirely into cash (3-month Treasury bills) whenever the S&P 500 index falls by 10% or more in a quarter, and then re-enters only after two consecutive quarters of positive returns.

We see that the forgone returns from trying to time markets add up over time. The Consistent Investor has outperformed the Market Timer by 189%[2] since 1999. Sitting on the side-lines and waiting for clear recovery could mean missing opportunities and long-term underperformance compared to being invested.

HYPOTHETICAL PERFORMANCE OF STAYING INVESTED VS. 'TIMING THE MARKET' SINCE 1999



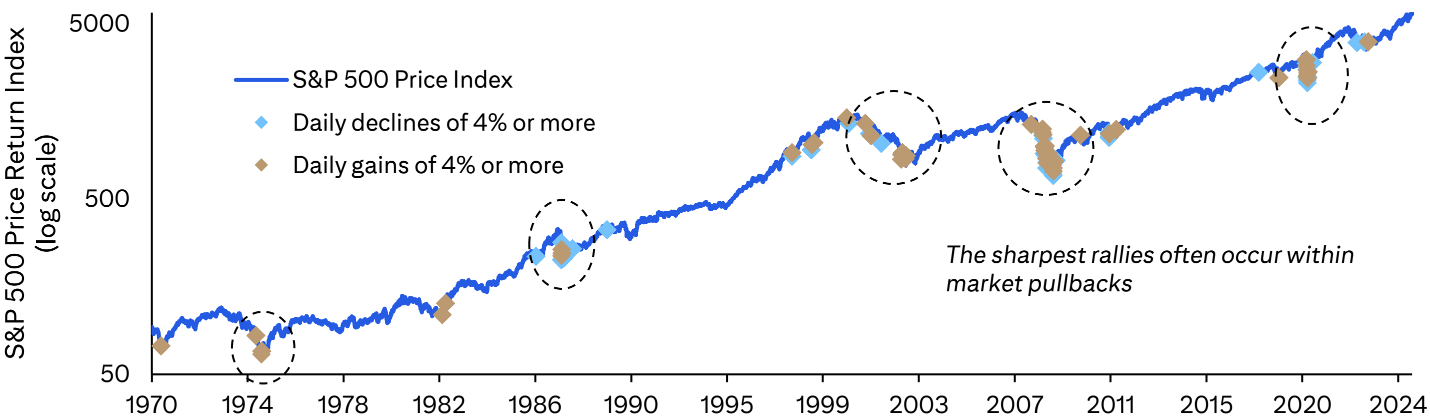
Source: Citi Wealth Investment Lab using Bloomberg quarterly data from 31 December 1999 to 30 September 2024. The Consistent Investor is invested into Equities throughout. Market Timing Investor begins invested into Equities but switches into Cash if Equities fall by 10% or more in a quarter and invests back into Equities only after 2 successive quarters of positive performance by Equities. Equities is the S&P 500 net total return index. Cash is the BofA ICE 3-Month US Treasury Bill Index.

Turning points are hard to identify

Timing the market can be costly because identifying market turning points is difficult. The best days for asset returns often occur very close to the worst days during periods when prices are generally trending downwards, as the below chart illustrates for the S&P 500 index.

Since 1970, more than 90%[3] of daily S&P 500 index gains of 4% or more occurred when the index was more than 10% below its most recent high. The chart below shows that there are often multiple rallies of this strength during down markets, which can make catching genuine turning points challenging. Additionally, missing out on being invested during these days can be costly.

HISTORICAL PRICE RETURNS OF THE S&P 500 PRICE RETURN INDEX



Source: Citi Wealth Investment Lab using Bloomberg daily data from 2 January 1970 to 8 October 2024.

[2]Calculated between 31 December 1999 and 30 September 2024.
[3]Calculated between 2 January 1970 and 8 October 2024.

Indices are unmanaged. **An investor cannot invest directly in an index**. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. **Past performance or correlations are no guarantee of future results.** Real results may vary.

This analysis applies beyond the S&P 500 and similar results can be found for non-US equity markets.

Key takeaways

- Being invested can be a way to meet investing goals over the long term. However, challenging market conditions often lead investors to exit the market and remain uninvested until a recovery appears to be clear.
- ETF investment flows suggest that investors **often fail at market timing** – waiting until both downturns and then recoveries are clearly established, and in this way exiting the market 'too late' near the bottom, and also re-entering 'too late' and missing much of the recovery.
- History shows that this isn't surprising given that **the best and worst days for market performance often occur close together**, with some of the strongest performances occurring during overall market downturns.
- Over time the **opportunity costs** (compared to remaining invested) of **such mis-timing can compound** and lead to significant underperformance compared to a strategy of staying invested.

Appendix

Glossary
Disclosures

Glossary

Exchange Traded Fund (ETF)

A basket of securities that trade on a stock exchange. ETFs are offered on a wide range of asset classes from traditional investments (such as equities and bonds) to alternative assets like commodities or currencies.

Index

An index tracks the performance of a broad asset class, such as all listed stocks, or a narrower segment of the market, such as energy stocks.

Inflation

Inflation is a general increase of the prices of goods and services in an economy. This is usually measured using the consumer price index

Log scale

A way of displaying a range of numerical data in a compact way. Equivalent vertical distances on a log scale represent the same percentage change in the index between two periods

Net Fund Flows

The difference in inflows (purchases) and outflows (sales) of an Exchange Traded Fund or a group of Exchange Traded Funds.

S&P 500 Net Total Return Index: Net Total Return (NTR) reflects the total return of the index where any dividends are assumed to be reinvested net of withholding tax.

S&P 500 Price Return Index: A market-capitalization-weighted index of 500 leading publicly traded companies in the US.

Barclays US 3 Month Libor Cash Index: This index represents cash returns related to the 3-Month US Libor interest rate, representing returns from US cash investments.

Disclosures

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