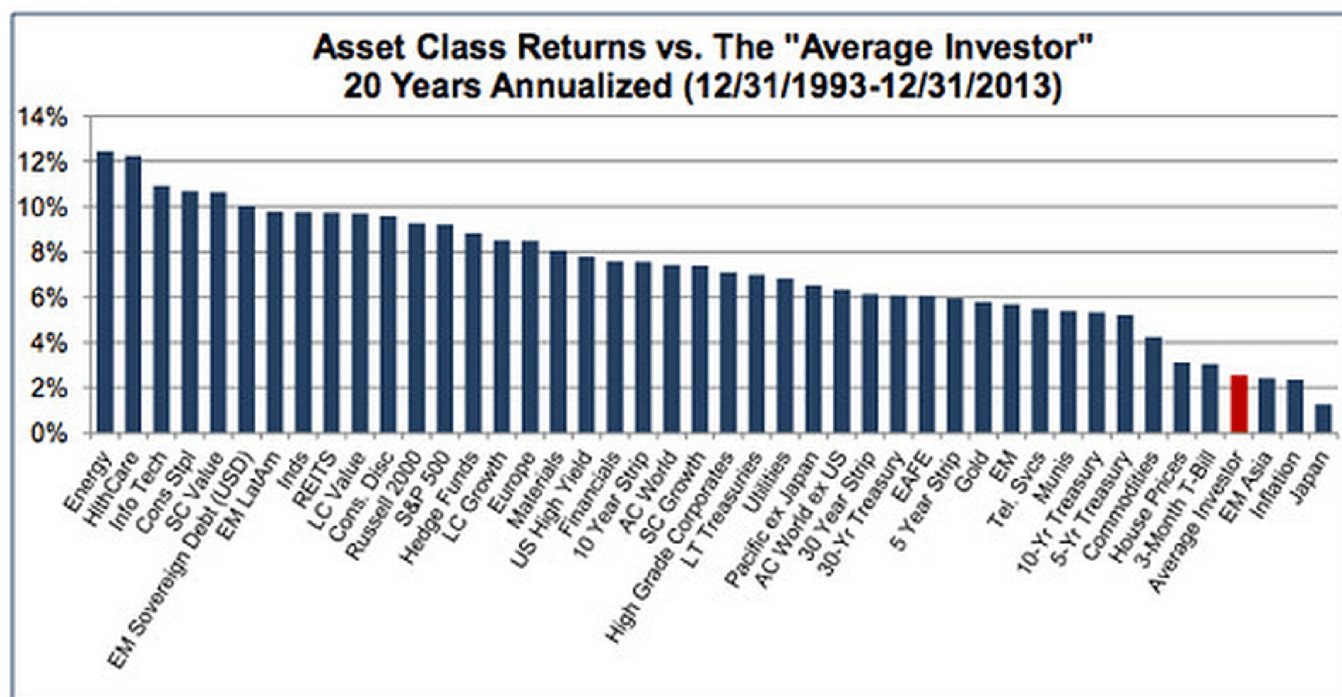
Buy and Hold vs. Timing the Market: Which one is better?

There is debate that has been going on for decades and decades. Of course the two sides of the debate both think they are correct when answering the question **which is more profitable, buy and hold or timing the market?** Before I give you my thoughts and answer that question,(which is probably different than any answer you have heard before), let me attempt to make an argument for both.

Buy and Hold

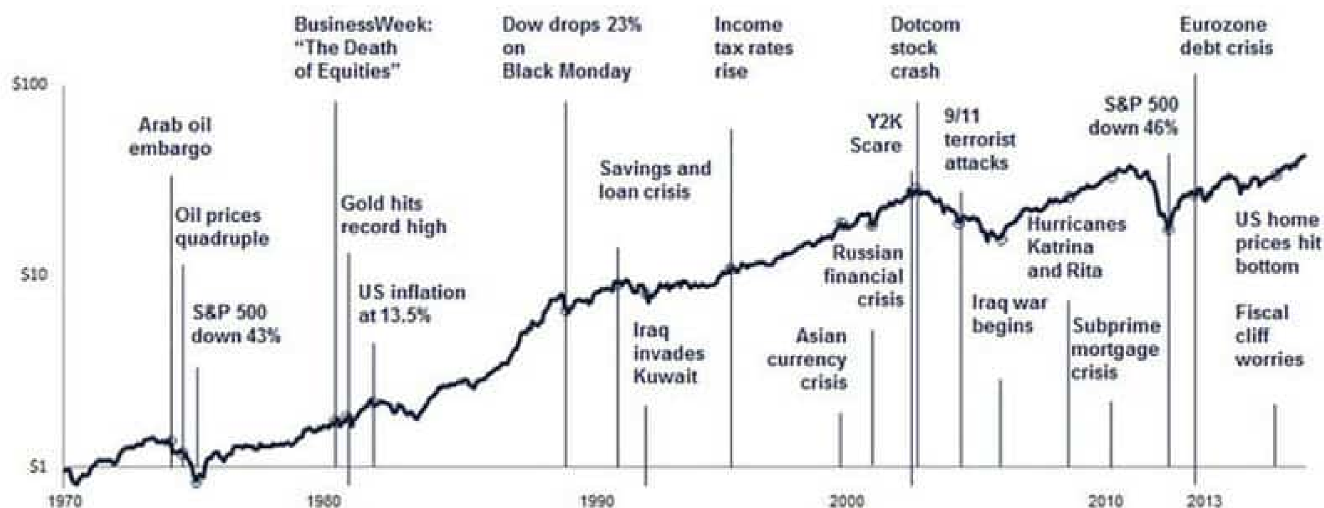
To make sure we're all on the same page buy and hold would mean buying a stock, ETF, or mutual fund at a price you are comfortable with and never selling it. That definition seems obvious and the concept seems simple. However, it's probably one of the hardest investment techniques for most people. Emotions, fear, and lack of discipline are just a few reasons why people have a hard time staying true to the buy and hold investment style.

Below is a chart from an article written on MarketWatch.com titled, "1 chart shows just how badly average investor lags — even cash." It highlights that when investors try to time the market and leave the buy and hold method behind how badly they perform. You can see where the individual investor is on the far right hand side of the chart (right next to the 3 month T-Bill).



It's important to note that the probabilities of the market moving higher over time is greater than the probabilities that the market declines over time. That's just how the market works. Another one of my favorite charts

from Dimensional Fund Advisors illustrates these probabilities. I love this chart because it highlights the news associated with the given time frame. Some of the news events on the chart were horrible. However, what did the market do? Despite the horrible headlines, they went higher. No question that the title of this is named perfectly . . . “Markets Have Rewarded Discipline.”



Timing the Market

Enter the concept of timing the market. Timing the market is essentially the concept of trying to pick the bottoms to buy and the tops to sell (buy low sell high). There are several popular strategies for timing the market, the most popular is the use of moving averages. Whether it be a 200 period simple moving average or a moving average crossover system using two different period moving averages, the concept is the same. When you see price fall below the moving average you get out, when you see price rise above the moving average you get back in. Below is a sample of that type of trading methodology using a 200 period simple moving average. The entry signals are green and the exit signals are red on the chart.

You can see that by employing a strategy like this you are potentially able to avoid (if you're disciplined) the major drawdowns in the market. Note that you missed the bear market of 2008. However, you may also notice that there were a lot of false signals. In 2010, 2011, 2012, and 2014 there were many false signals causing you to get out and get back in. Each false signal costs you money in terms of commission charges and missed opportunity of just staying in.

Another one of my favorite timing systems is one that we have discussed before in the article called "Our Rule #1 – Risk Management." It discusses the 10/40 moving average crossover system. To read about it click here.

Before I even try to argue that timing the market outperforms buy and hold I will just say this, most times it doesn't. **In fact from 1994 – 2013 buy and hold outperformed the 10/40 crossover method by 28.10% on the S&P 500.** When you factor in the compounding effects the out performance of the buy and hold is even greater.

So why would anyone even employ a timing strategy like a moving average crossover if over time it doesn't outperform? Below is a list why timing the market may make sense for some investors.

- The ability to short the market. The numbers above do not include shorting the market. Some individuals use a bullish exit signal as a signal to short the market. This type of strategy can improve overall returns.
- Portfolio Draw-downs. Some investors just flat out can't handle buy and hold psychologically. They just freak out when they see a draw-down of 50% (like 2008) and then they react in a way that can cause further damage to their portfolio. During that last two bear markets the approximate draw-down of the 10/40 crossover method vs. buy and hold were . . .
    - 2002 = -13% draw-down (10/40) vs. a -47% draw-down (buy and hold)
    - 2008 = -17% draw-down (10/40) vs. a -56% draw-down (buy and hold)

So which is better, buy and hold or timing the market?

So which is it? What is better for investors, buy and hold or trying to time the market? Drum roll please . . . . ***it totally depends.*** The answer for you depends on your life situation and how much risk your can handle in the market.

Buy and Hold: If you are young, 20, 30, 40 years old then buy and hold would most likely be your method of choice. You have plenty of time to allow the market to work for you. You can withstand a drawdown and will most likely be just fine. Growth is more than likely what you are after so buy and hold makes sense. The ability to compound returns (think dividends) and dollar cost average into positions is something that will allow you to grow, build wealth and plan for retirement.

Timing the Market: Now if you are on the cusp of retirement or are in retirement then a draw-down of -20 to -50% could be devastating. How many stories did you hear about people in 2008 who were in retirement that were forced to go back to work because their assets were crushed? I know of a few people personally where this was the case. If you're in retirement or near retirement then the concept of timing the markets may make sense for your given situation.

In summary, there is not one strategy that is better than the other. It totally depends on the investors given situation. The important thing is that you get with your own financial advisor and figure out which strategy is best for you given your situation. Certainly we at Iron Gate Global Advisors would be more than happy to have that conversation with you. In the complex global markets which we now find ourselves, asset allocation and diversification alone will not be enough.

Successful investing!