Episode 57: Market Timing Still Doesn't Work

Bob French 00:00
The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. You know what the most important rule of market timing is, don't be wrong. We're still working on that part.

Alex Murguia 00:49
Hello, everyone. I'm Alex and welcome to Retire with Style. here with Dr. Wade Pfau. I think I've ever said that one Wade. And Bob, Robert T French.

Bob French 01:05
right? Yeah, just just to put it out there. I'm actually the least educated person here. I'm the only one without a PhD. So Dr.

Alex Murguia 01:13
No, you're a CFA charterholders. Oh, no, Bob, the only one that can call me Doctor is my mom. So she's required everyone else. It's Alex. Seems more natural that way, besides, if you tell everyone that they'll all lose faith and faith in the educational system. So on with the timing, right. Today's episode, we're going to drill down into market timing. And, you know, well, let me not steal the thunder here. Bob, why don't you give it the type five before we get into it again?

Bob French 02:02
Yeah, I don't know that I have a type five on market timing or anything. But you know, the basic idea we've talked about your little past two weeks, kind of the the opposite ends of you know how people approach trying to beat the market for lack of a better way of saying it. So you know, a couple of weeks back, we talked about technical analysis, which is the the crazy chart people who think you can look at, you know, those charts of stock movements and be able to predict what's going to happen next. Last week, we talked about fundamental analysis, which is the crazy spreadsheet, people who want to run all of the numbers and figure out, you know, the exact price that Tesla should be trading at, or what the s&p 500 level should be. And then, you know, hope the market catches up with that. Today, we're talking about kind of the wishy washy middle, which is kind of the general approach to market time, which is, for lack of a better word, kind of just trying to guess, where the markets gonna go, is the market gonna go up? Is the market gonna go down? Is this stock gonna go up? Is this is the s&p 500 gonna go down?

Alex Murguia 03:17
So it's kind of in the middle of both

Bob French 03:19

In the middle of both people pickand choose from both kind of approaches to figure out, you know, how do I get, at least in my opinion, how do they get to the story they want to be telling, you know, I, I kind of think the markets gonna go up. What can I cherry pick from both of these different schools of thought, to get me to that result?

Alex Murguia 03:42
Or could it be sort of an endurance thing? And what I mean by that is, let's say someone's doing fundamental analysis, right? And thereby their third, you know, balance sheet adjustment. And then they say, you know, three days into it, you know, what the hell? How does this chart look like, you know what, I'm good? I'm buying Yeah, it could be like that, where someone just gets exhausted and says, let me just look at the chart, or they're at the charts. And they have so many different signals that they're like one says, buy one says, sell says, hold, one says neutral one says strong buy. One says, whatever, you know, and they're like, let me just quickly go to Yahoo Finance, and look at the financials and the, you know, the basic piece price to sales, trailing 12 months and call

Bob French 04:38
it a date to the shortcut. It's, you know, wait, you look like your

Wade Pfau 04:44
mind. Yeah, I don't follow the cutting edge of the market timing research discussion necessarily, but don't think that sure you don't wait isn't been this is more looking at market indices. Right. It's is it also people are trying to market time individual stocks, are they

Bob French 05:01
market time, the length of your beard if you give them away so, well,

Alex Murguia 05:05
I think what Wade is saying is market timing individual stocks is kind of a jumbo shrimp kind of an oxymoron to some extent the way the way, you know, time is. I think maybe they're using Yeah, exactly. Maybe they're using like a macro analysis tool to kind of also dictate because there's the argument of, you know, it's hard to fight the Fed. So to some extent, I need to be just talking he's gonna have some component of that, by the way, Bob, I a more pressing question. And for those for those listeners, please. ear muffs. ear muffs. Wade, are you cold? Wade is invalid and cold today, Bob and I are in the northeast and Wade is all like, parka'd up? Parka? And we're like why? It's freezing there?

Wade Pfau 05:52
the weather. It's pretty wild and volatile these days.

Alex Murguia 05:55
And by the time seven degrees here,

Wade Pfau 05:58
it was really, it's not anymore. I think we're getting the tail end of that storm going through the north part of the country.

Alex Murguia 06:05
Okay, all right. For those listeners, you can take your earmuffs off now. And we will continue I was just surprised. Wade is like the you know, he's dressed like him. He's ready to go outside kind of thing.

Wade Pfau 06:15
Yeah. By the time people listen to the episode, it may be at again. So who knows?

Alex Murguia 06:24
Alright, so, so. So macro, macro timing is an oxymoron for an individual's thought. But, uh huh. It's not because

Bob French 06:34
I mean, so this is where kind of it comes down to that wishy washy and the terminology is really, really just kind of all over the place. You could, you could, as you're doing, making the argument that, you know, market timing is really this, this big, broad thing, do I think the market as a whole is gonna go up or down or whatever, you know, in doing it at an individual stock level is something slightly different. But, you know, we're kind of lumping it all together in saying, you know, okay, I think Tesla is gonna go up, or it's gonna go down. And, you know, maybe there's a slightly different term that we should be more precise in using. But, you know, I mean, it's kind of all under that same rubric, are you're trying to guess, where the market is moving and move your investment strategy or your investment tactics more appropriately? Along with that? Okay.

Alex Murguia 07:41
Well, Wade did that satisfy?

Wade Pfau 07:47
Yeah, you brought it up, I never really thought about market timing, from the perspective of individual securities, I suppose I would think of that more as technical analysis. But

Bob French 07:56
yes, it's a very blurry line. So.

Wade Pfau 08:03
Okay. So so we've established it's some sort of hybrid between because it may, to the extent that there's any theory behind it, it's probably drawing both from the technical analysis tools, in terms of talking about well, we're above the average over the previous

Bob French 08:21
it's exactly what CNBC does. So Alex, you know, your, your lunchtime viewing, that's by and large, that's the market timing stuff. You know, they're they're pulling little bits and pieces to tell the story they want from, you know, hey, their balance sheet looks good, you know, the prospects are good, versus Hey, they got this resistance level is the same time.

Alex Murguia 08:41
Hey, Bob, unless you've watched parlent with me, please refrain from any opinions. Okay, cuz you don't know what I'm watching. You don't know what they're talking about those first 10 minutes, like go get Bob. Now, no, no, no, I live. It's true. The issue I get with the market timing piece. And I, you know, I think there's a lot of platitudes out there, right. It's not timing the market, it's time in the market, a hot you know, that kind of thing. But I would say this, if we get the you know as prospects come in, and we have meetings, and I don't do these anymore, so many of you will be thankful for but as you know, there's these meetings that that occur, etc. What we get a lot is I think the general consumers understand this. And there's kind of a little bit of a scarlet letter to say that I'm a market timer. And there's a lot of people that say, Oh, I'm not a market timer, because they think that's your everyday going in and getting out getting in every day, right? Or every whatever, right? But the always it always comes around like I'm not a market timer. But But and we'll talk about but the market is obviously overvalued. And so there's no way I'm going to do whatever, but it's obvious the market is undervalued, and there's no way I'm going to do whatever. I think that's where it's in many ways more more nefarious than if you were just a, an open. Yeah, I'm a market timer guilty kind of thing. Because at least there's some level of acknowledgment. But the folks that get me that I think, really, you know, they can they can do, okay, they can do, okay? are the ones that are one of these, like closet market timers. I'm not a market timer. But if you find yourself kind of talking to somebody else, and I'm talking to Bob, Hey, Bob, you know, when COVID, you know, was happening, and we were all locked down enough to the markets went up, you know what, I had to sell zoom, because I realized it was so high, and it had to go down. I don't usually do this, though. I just did it with this one, you know, or I just did it once or twice in my entire life or things like that. That's a very slippery slope. I, in my, from my experience listening to people, there's two scenarios that usually happen. The one that doesn't, is they get it right, then they get it right, then they get it right, then they get it right, then they get it right, then they get it right. And they own the world. That never happens. I've haven't run into anyone like that. So maybe I can't say never. Right. So that's, that's outside of normal limits in a major way. What usually happens is, look at this, I got it right. I'm a genius. I got it right. bogged down before me. I didn't get it right. This time. That happens. I got it. Right. I you know, and after a while, it just follow random pattern. And hopefully they haven't run out of money. You know, but I think the most dangerous thing to market timing is to get it right the first time because then I don't know is there's this sort of rush. And that's my PSA announcement for the day, or at least for the first 10 minutes is there's market timing, like folks that are at CNBC or you know, that kind of thing, right. But then there's market timing these under the water market timers, that won't like admit to others that their market timing, and they rationalize to themselves, I only do it a couple times what obvious signals are there.

Wade Pfau 12:10
Yeah, and these are new behavioral biases, that just with behavioral biases, I think it's natural for people to be able to tell themselves the story that either they forget the times that they didn't do it, right, or whatever, they are just, they have this feeling that markets may go down, or they may go up or whatever the case may be. But then the trick is to not act on that. And to not trade on that you recognize, like when COVID was happening, I was like, Okay, I think the market is gonna go down. But then the important thing is to not act on it, and to not panic and sell everything. And that's where really the trying to have some sort of behavioral way to manage this sort of natural tendency to want to

market time because it's a story that can sound nice to people. That's where the real discipline comes in, to not act on those thoughts,

Bob French 12:59
even more than it sounds nice. I mean, it's literally how we think, you know, we're worried about, say, the market going down or missing out on was really great market opportunity where it's gonna go up. So we do something about it. And the dangerous thing is, you know, as long as we're saying the markets going up or going down, you got a 50/50 shot, you know, it's effectively a random walk in pretty much any reasonably short time period, half the time, you're gonna be right, just by chance. And then you keep building on that, as Alex was talking about.

Alex Murguia 13:32
But you have another point here about the probabilities. But let's, let's push that back for a second. Because I want you to address the, okay. Alright, guys, I get you, I hear you. But you know, what, I'm not using my spider senses to tell me to get in or out of the market. I'm actually using traditional valuation ratios. I'm not using the triple lending. I'm not using the I don't know, the Fibonacci continuum. I'm not using string theory or whatever, you know what I mean, I'm using actual hardcore, traditional tried and true valuation metrics, like the PE ratio, and it's the PE ratio is, you know, whatever, way above its historical average. So you got to be kidding me telling me that it's not going down?

Bob French 14:21
Yeah. So there's, this is one of those where it's, it's not as cut and dried of a sound bite as we might want to be able to make, because there is value in the P in the K by extension in, you know, a lot of these different metrics, because it gives you information on the price relative to the fundamentals in the economy. And what that does is it gives you at least a little bit of a sense of what forward looking expected returns in that market or you know, whatever that valuation metric is telling Yes, or is looking at I should say, it gives us some general sense as to what the expected return might be in the future. Now, the question then becomes, okay, how much play is there? What's the error bar around that type of thing. And those numbers are just phenomenally massive. You're there, there are some very intelligent people who I respect immensely, who, you know, do make a habit of calculating out, you know, here's what the current P ratio or the cape ratio implies for what the expected return is going to be. And they'll do it out to like four decimal places. It'd be on an intellectual exercise, I don't think there's any value there. I don't think it's any value in terms of, you know, at least at a tactical level, how we build out our portfolios and their strategic level, when we're designing our very long term asset allocation. That's definitely a piece of information we're using. But I wouldn't be looking at it in terms of, you know, this means I should buy more, or this means I should buy less. It's more of, you know, over my 30 year retirement horizon, kind of what numbers do I plug in for my planning purposes? And Wade, you got a good point on this about, you know, Shiller when he with his papers and a lot of this stuff around the Cape ratio there as well?

Wade Pfau 16:41
Yeah, I mean, Schiller wrote the his article on the cape ratio, the cyclically adjusted price earnings ratio, I think the first one came out in 1998. And when you looked historically, before that point, it provided pretty good predictive power about just that's fitting the line through the data. When the cape ratio was

high, the subsequent stock market returns tended to be lower, and vice versa. But it's kind of like what happens with a lot of this, once people saw that point, the relationship broke down. And if you were following that sort of guidance, you would have been spending most of your time since the mid 1990s, with the lower stock allocation, because you were worried that markets were overvalued, and you would be experiencing a lower return from those stocks. Now, we've seen there's been a lot of years that have passed since the mid 1990s. And for the most part, it probably wouldn't have been a great idea to not to have a lower stock allocation that whole time, because you were worried that because the cape ratio is predicting lower subsequent stock market returns. And that's where I think ultimately planning conservative assumptions for retirement. You might not want to assume historical stock market returns when the cape ratio is higher. But beyond that, I don't think we can really gleam a whole lot of information from something like the cape ratio.

Bob French 18:06
If you're looking for more personal advice, please know that our show is sponsored by McLean Asset Management, learn more, and McLeanam.com. That's McLeanam.com. McLean Asset Management is a wealth management firm where we help you design and implement the right retirement plan for you.

Alex Murguia 18:28
No, I, I agree, I think and Bob was making a point with regards to these fundamental levels, and the like, and it's, it's not like the cape ratio, and let's just say use Cape ratio and PE interchangeably, right? They don't go up. They don't double overnight. Now, they don't tell, but it's not like you woke up today. And while the P ratio was at 40, it was 20.

Wade Pfau 18:55
Yesterday, something's off stock market doubled.

Alex Murguia 18:58
No, no, but like, overnight, like the start of trading. I mean, like, it's 430. And then at 920, it's, you know, double, you know, barring US landing on the moon and finding rare metals overnight, that signal at the dawn of a new age, you know, kind of thing. It's not going to happen, the point, the point, the larger point is that it creeps up. It goes from 12 to 13 to 14, etc, etc, etc. Or, you know, whatever it goes up and down, but it gets there over time. It doesn't just instantly seismically you know, gap up like that, you know, from from that vantage point? Yes. Wade, subject some sort of nuclear holocaust or something like that. Yeah. I don't expect it. You know, and so,

Bob French 19:45
yeah, no, but let's be precise here about how,

Alex Murguia 19:49
yeah, think of an example of some sort of seismic move. I use Mars to go up. I'm using the Holocaust thing to nuclear holocaust thing to go down. But yeah, I mean, it has happens over time. And what I'm getting at is, little bits are being made every day based on those probabilities. And so it's not just there it is. It's it's at 30. And I've never noticed it. It's, you know, it's, it's an everyday occurrence. And so just because it's up, if you will, doesn't necessarily mean something's wrong. I mean, I would venture to say,

it's capitalism, things should be hitting all time, all time highs, constantly, simply going back to the milk example, and forget the inflation that's happening right now, you know, kind of thing, which is like, whoa, look at this craziness of eggs, right. But if I go and buy, it's not like anyone says, Hey, Lucky Charms is at an all time high today. You know, you don't think about it, you know, you kind of expect it. Yeah, it should be it should cost more today than it did 10 years ago, or than it did 20 years ago, normal sort of inflation or normal kind of progress of time, if you will. And so I think I think what I'm trying to get at here is this sort of idea that markets are at an all time high, PE is at an all time high. This is at an all time high. I think that's a natural function of just the economy expanding, which is an expected headline, you know, that you should embrace and not necessarily run for the hills because it's time for a retracement?

Bob French 21:24
Yes, absolutely. And just to echo that point about, you know, the PE ratio, no one's ever surprised by the PE ratio. You know, whenever it's gone up, that's because more people are buying at that point. They're saying they're, I mean, absent earnings going down. But during the year, people are saying, Yeah, I want more of that, I'm more than happy to pay for, you know, whatever the PE ratio is, that's how this thing moves. And at every point, people have been happy with where that PE ratio is. So it's not that it can hit some trigger, and then everything comes crashing down. A lot of people seem to be looking at it in that way. But that's just not how this works. It's a flow. It's not, you know, something that's jumping out at you. So,

Wade Pfau 22:24
like advocates of the way I've heard them explain it is you attach a rubber band to the historical average value. And so as you move away from that you're pulling on the rubber band and so it's creating more and more pressure towards the middle and at some point it could snap but

Alex Murguia 22:41
The the retort of her to whose side are you on anyway? Commentary. The retort, I just wanted to be fun. The retort I've heard to that is, okay, I get it. But how do you know that the historical average doesn't ever move? I think it's Westman. Actually, that I first heard it from who do you know, what do you know about what the historical average should be? In that it doesn't move? Yes, I can do the math and do a sum and an average and etc. And figure out historically, it's the 18th. But how do you know that? It doesn't? It's not 19? Now?

Wade Pfau 23:23
Yeah, you know, I even had an article on that concept of like, as societies grow wealthier, the returns on capital decline, and so naturally, that will push up the kind of average valuation level over time and just a trend that you see.

Alex Murguia 23:40
That would be my that would be my retort as well, because I think it makes perfect sense. Like, okay, I get the whole, you know, there's a rubberband thing, or trees don't go to the sky trees don't grow to the sky, you know, etc. But the reality is, is how do you know what that anchor point is? Where's that anchor point? You know? And why does that? Where does it say that it has to be the same, you know,

forever and ever and ever. You don't know that. You know, the the other thing that I that I kind of never get past and you said it when you did your 50% thing. And this is kind of what I go, this is my go to when like a buddy or something like that asked me about getting in and out. It's if they don't by the arguments of the PE stuff that we talked about, or the fundamentals or listen, if all time high and that that's a natural kind of thing. It's you have to be right 50% of the time to get out or to get in, but then you have to be right another, you know, but then to be right again, so being right twice. 50% times 50% looking at a 25% shot here, and for what really and the worst thing you could do is be right on that one. Because you're like a member for life. That kind of thing. You know, it's like, you know, unless you hit zero, you're gonna double down and double down you know, kind of go So you gotta be very careful, because just look at the odds. Okay, you had a 25% chance that could happen. It's, you know, one out of four, you know, congratulations, right. But then you do it again. And these are independent samples. But the odds that you're going to be right, on four ways, consecutively, just do you know, continue to multiply by 50%? Every time every iteration continuing to multiply by 50%? And those are the odds that you would have been correct for that many number of times. I mean, that that alone, you would never do this with anything else with any kind of decision. You know, but with money for whatever reasons, like Yeah, you know what, I'm feeling good. Let's do it. And so just from a product probability basis, point of view, the odds are just stacked heavily against you. Let's say you're not gonna get it right want not saying you're gonna get it right twice? It's just it's not worth it. And I said this and something I want to point out, and how would you answer this? Because I don't, I'm just curious what your opinion are here is here. Wait. And Bob, if someone says to you after listening to the last few podcasts, Hey, folks, I've heard this. And let's cut out the chitchat in sort of a podcast to begin with. But as an aside, it seems to me that you're saying any potential reason that something is successful, is by chance, or is by random is by a random draw. And I have trouble digesting that. Because it seems like an easy out for you to say, Yeah, but they're just lucky. What would you answer? What would be your answers?

Bob French 26:44
So I would say, Well, Wade, let's let you go. First. I want to see, I want to see you stumbled through this answer before? I do.

Alex Murguia 26:54
No, but it's a fair question, right?

Wade Pfau 26:58
Yeah, and I would lean towards the idea that there probably were lucky and that, with as many people in the world investing, just by random chance, there's gonna be some people who have a string of consistently correct bets on whatever it is that they're looking to time. And so it's really hard to distinguish skill from luck. And I this may be looking ahead to future episodes. But when you start looking at the studies of the performance, and people who may have had a good string where they looked like they were skillful, and knew what they were doing, but then you just do a reset, and now looking forward from that point, how do they do? They don't tend to be able to keep that performance up. And so I would not discount the role of luck, in that sort of temporary over performance that someone might have enjoyed.

Bob French 27:49

Yeah, no, that was that was gonna be my go to answer there as well, actually, you know, the subsequent performance studies, I think, are a very, very strong nail in the coffin here. When and we'll talk about this in much more detail, I believe next week, actually. Where, you know, if you look at people who won in one period, that literally tells you almost nothing about what they'll do in the next period. It there, it's a completely random shot after that. So you know, there definitely does seem to be some luck there. The other thing I would caution on here is that, you know, yeah, it does matter, you know, for a company, you know, if we how we run Risa, or retirement researcher, McLean, that matters a lot. But that information gets

Alex Murguia 28:42
what's that? What is that corporate finance matters and

Bob French 28:45
Running a company? How much profit you're going to make obviously, perfect. But all of that information gets absorbed into the, into the stock price, effectively, immediately. That information is already in security prices. What matters is how does that next piece of information square with what the market expects? So you know, right now, you know, well, I guess Twitter is not a publicly traded company anymore. But Tesla, you know, Elon Musk, the market I think, has come to kind of the conclusion. He's, he's a little bit scattered right now. That's built into Tesla's price. If Elon Musk comes out and you know, has is a brilliant manager going forward, the stock price is gonna go up. If he kind of keeps stumbling around. That's already in the price. No one that's already how people are expecting him to be acting.

Alex Murguia 29:49
And so you could make the is it fair to make the case you're talking about a stock now we kind of talked about that last in the last sort of episode where we're bringing fundamental analysis, but you can make the case that that's Then Tesla example generalizes to the US economy is a PE valuation metric. Absolutely. And I would venture to say, when you're talking about the entire US economy, I mean, you have more, you know, there are more eyes on that, I would think. So it's uh, yeah, it's like, what do you bring into the table about the PE ratio, that no one else knows that you you think somehow, you know, you listened to CNBC the other day and Jamie Dimon was talking to Kramer and he told Cramer that expect inflation at 6%. And so you heard that before 99% of the other investors. And so you know, you acted quickly. Use your mobile e trade thing and put in the order and off you go. I mean, I mean, I'm exaggerating to make the point. But it's I don't think it's too far.

Bob French 30:52
That's not even an exaggeration. I mean, it gets back to you. We talked about high frequency traders A little while back, the server plate or server farms they use, they literally measure out the cables to make sure that everyone in that server farm, their signals are traveling exactly the same length.

Alex Murguia 31:11
I wasn't even thinking like that. I was thinking like, What the hell does Jamie Dimon know that? You know, everyone else doesn't know. And I respect Jamie Dimon is a great CEO. But I'm talking about

market prognostications about where inflation is going or whatever, I don't care if he gets like, top secret. JP Morgan reports. It doesn't matter. Math is man.

Wade Pfau 31:33
Yeah, but I mean, to Bob's point on that is if he did have the accurate information, and he revealed it doesn't show, you're gonna have a hard time being the quickest actor to take advantage of that information.

Alex Murguia 31:45
Yeah, no, no, no, you're right. You're right. I think too, because we could say this. But I think there's a couple of attractions to market timing, you know, regardless of levels, but I'm actually I'm not even talking about the person that market times every day, because they're not listening to this, it's really more the person getting ready for retirement, and they have a milestone decision to make, and they're delaying it, or they're acting a little quicker than they should be simply because of where the market is now. That's the market timing that I think is more troublesome for me. You know, the other people, they kind of know what they're getting into, they have to you know, it's it's a pure consumerism kind of thing. This is more people that are, you know, foe investing to some extent, and bringing in speculation to the mix. I think it's easy to see why though, right. And I think it's because of the whole psychological piece where I feel pain, you know, I'm gonna remove that pain, by selling or by whatever, I'm gonna I don't feel the pain now. But guess what the 5050 chance if it didn't hit, now you feel pain again, and you reverse it. And then you just rinse, repeat, rinse, repeat over and over and over again? And then see what happens later. And that ruins that ruins retirements. I mean, market? Wade, huh? How much did the success of market timing factor into your sustainable withdrawal rate studies?

Wade Pfau 33:11
Well, that's the thing about the sustainable withdrawal rate studies, they they assume you never you stick to your asset allocation that was predetermined before the study. And so there is no market timing. That's the point, right?

Alex Murguia 33:26
The larger point is, who cares about when to get in, when to get out, etc. The folks that are listening to this are here for you know, retirement income, right. And so this is just not needed. You don't need to add this extra, this extra arrow, if you will. And, and that's, that's, that's giving it the nice assumption that you're going to be correct. Most likely, it's going to be what do you call the firecrackers that don't, that don't like, shoot a dud? And that's a dud, that's a dud. And you're sort of in your quiver, if you will, I mean, you don't, you don't want to engage in that there's no need to and you got to, you know, you got to try to hold off in that sense, because I can't stress enough the probabilities are just so far against you. That it it's not a game you want to be playing at all. You know, I mean, the other piece is how much does greed you think get involved in this way? And Bob and I say this because if any, you know, there's some advisors that listen to this, and there's that old chart, you know, you know timing the market timing the market and if you missed the best day, the return I'm making it up right the return goes from 10% to 8%. You missed the best week ever. It goes from 10% to Bob you want to take a guess

Bob French 34:38
week level i A couple years back

Alex Murguia 34:41
whatever you know the you know the story on that story, right like why do you continue it so

Bob French 34:46
you know, there's there's always people on both sides the the argument people say mark, timing is the best thing in the world and market timing. People say market timing is bad. We'll go and say you know, if you miss the best month well Oh, shoot, look at how bad it would have been. So you don't want to market time. Conversely, people will talk about, well, if you missed the worst month, well look how much better you would have done. So clearly, just be good at it. You know, and you can run these numbers and slice and dice them all the different ways. And, yeah, the numbers look really friggin good. If you assume you can market time, you know, back in, I think it was in 2016, I ran some numbers. And, you know, if you assume perfect market timing, so you're in the market, when you know, you're in the s&p 500, when the markets are going up, and you flip over to, you know, one month t bills, when the markets are going down, you know, if you missed just the worst 10 months, this is from January 26 to July 2016, it went from slightly more than a 10% annualized return for the s&p 500 over that period, just missing those worst 10 months, jumps up to just over 13%. So a three percentage point difference. Conversely, you know, and we'll use the growth of $1. Here, if you missed the worst 10% of those months. So 109 months overall, you know, just holding the s&p 500, over that period $1 would have taken you to $5,800. If you missed the worst 10% of the months, that would have taken you from $1 to $254 million from 26 to 16. You know, obviously, great if you can get it just like waves example of you know, if the market doubles overnight, I'd love to try it. But you know, it doesn't, it doesn't bode well. Conversely, we can get, you know, just massive numbers. The other ways, if you miss just the worst single month, you do lose about 1000 $1,800 in terms of your growth of wealth coming from that $5,800. If you just missed the best month, you know that $5,800 drops down to $4,070. You know, if we miss the best 10% a month, you know that $5,800 drops down to 231 cents, every dollar turned into 31 cents there. So, you know, it's fun to play with these numbers. And you can do all sorts of fun things putting in lags and you know, measuring and preciseness and all that stuff. But what all of these really come down to is don't be bad at market timing, if you're gonna do it. Get it right.

Alex Murguia 37:56
Yeah, cause that's your raise your range.

Wade Pfau 37:59
It's bad. I like the number, the number you ran, where if you could perfectly time you're in the market in any month that it went up, you're out of the market in any month that you went down, your $1 would have grown to be $356 trillion. On that 90 year period, there's

Alex Murguia 38:18
That's not a bad, that's not a bad outcome.

Bob French 38:22

Yeah, that perfect timing strategy be real nice. If we could pull it off. You know, frankly, I would not be sitting here talking to you guys, if I could pull off that perfect timing strategy. But

Alex Murguia 38:33
yeah, like I said, I mean, this is kind of a fool's errand. I mean, and the reality is, you'll hear the stories from your neighbors and friends, when they hit when they got it, right. And they're gonna tell everyone about it. But not many people are gonna tell you when they got it wrong. And the other piece too, is they could get it partially right. But they don't look at their opportunity cost, hey, should have just stayed in the market and not pay taxes, and you know, got this in the, you know, etc, etc, etc. And they probably don't want to know, because they may find out that after five years of quasi market timing and being lucky, you know, there are people you know, someone does win the lottery, right. You know, after five years of this sort of thing, where they think they've had some moderate success, they don't go back and say, Oh, wow, you know, what, if I would have just stuck with it, and not bothered with his messiness. I'm better off, you know, and you got to ask yourself to what, why are you investing? Right? Is it is it to kind of beat some arbitrary bogey or to make yourself feel good about like your investment powers? Or is it to fund a retirement? Maintain your standard of living so you could do the things you wanted to do on a on a goals based level? I think it's the latter. And so at least the folks listening here and so that's the important thing. I mean, you got to ask yourself, why, why why do you want to even bother with this now? Wade And Bob, we spoke about market timing in general how it's this sort of hybrid between fundamental and, and technical. We spoke about how there's market timing addicts, but then there's also the, you know, in the closet market timers, which I think are dangerous, because those guys are the ones that are folks do it with their nest egg. There's the What about, but I'm using fundamentals, like PE ratios and Cape ratios and things like that. So what is the answer? There's, you know, it's the whole piece of look, there's alright, that's that's information that's out there. You know, what about bubbles? tiny bubbles. That's an old old song. What about bubbles? Okay. So, I love Bob's okay. Okay, yeah, you just like he didn't say, Oh, you didn't say okay, he's okay.

Bob French 41:02
You do you will just move on without comment here.

Alex Murguia 41:06
I think it's Don Hall or so it's an old like Hawaiian singer. It's like one of those cocktail lounges.

Bob French 41:12
I said, without comment here Alex. Curious if you should be looking at a Roth conversion, or what a Roth conversion even is, head over to McLeanam.com/roth to get McLean's free ebook is a Roth conversion right for you. And learn about when you might want to do a Roth conversion. And when you might not just head over to McLeanam.com/roth To download your free ebook today. So the thing with bubbles, is, there's a lot more of them predicted or talked about, then actually happened. So there's always that issue that we gotta be dealing with, when we talk about, you know, these big market movements. You know, people are constantly predicting these things. You know, I remember I want to say way, do you might remember this, it was I want to say 2017. The VIX, which is kind of a the market's prediction of what the volatility of the s&p 500 will be next month, it was really, really low. And

everyone was talking about how that's a sign that the market is just gonna fall apart, and everything is going to come crashing down.

Alex Murguia 42:28
Because no one is worried. And if everyone is worried, that's when that's just silly. A real fan

Bob French 42:34
Gets put out there. And eventually, something's gonna hit. You know, it's the, you know, I predicted 10 of the last three recessions or something like that, whatever that quote happens to be I forget it off the top my head. That's pretty good. But it's exactly the same thing here. So there is that issue to deal with? The other is that how we think about bubbles and crashes? I think is a little bit skewed. You know, Alex, you made this point with regards to mean reversion what's okay, the historical average is x. But that's not to say that it's going to continue to be x or that's the, the anchor point, if you will, it's the same thing with how we price risk, how we value risk, how we price risk, moves through time, and incorporates new information. And when that changes quickly, when we feel differently about the market, and about our willingness to hold risk in the market. Prices are going to move incredibly quickly. So you know, 2008, this is a good example. You know, because the mortgage market fell apart. What did that have to do with tech stocks? Seriously, why did that have to do with tech stocks or, you know, some of these other parts of the economy? It didn't necessarily have anything to do with it. What it had to do with was how willing we were to hold risk. We all got really, really nervous for good reason. So we just didn't want any risk. We wanted to get rid of risk in our portfolio, because we were also seeing how other people were reacting to it. And we basically didn't want to be left holding the back. Well, that meant we saw what that meant. That meant everyone sold. And the market dropped by 40%. It's the same thing during above your look at the tech bubble. This is another easy example. You know,

Alex Murguia 44:46
and it can't stress enough. A bubble is not like, oh, things have been going on for two weeks. They're interviewing someone on TV and they say, oh, there's a bubble in real estate or there's a bubble in semiconductors. They just do that because it's gone. up to much over the last two weeks. So there's a bubble. It's become kind of common jargon. So it's reduced the emotional tenor of that word. Bob is when he uses bubble he means

Bob French 45:11
South Seas bubble type of stuff. Yeah, yeah,

Wade Pfau 45:15
Tulips.

Alex Murguia 45:16
Right. Yeah, exactly.

Bob French 45:18
And, you know, it's just the the inverse of the crash, it's people are really, really excited about all these tech stocks. You know, putting .com, after their name actually Wade, you may have seen this paper A

while back, there was a paper that came out, I want to say it was in 2001. Where are they? They looked at when companies changed their name to put.com at the end. And that actually moved stock prices, materially move stock place prices for multiple months, just by putting.com at the end their name. People were so excited about this. They were devaluing that risk, they were so much more willing to hold those companies that they were willing to just buy up the price. Now,

Alex Murguia 46:08
the put the way because I could still be listening to this and still thinking, Yeah, but that's why it's a bubble. That's why it's irrational, because they were too exuberant. Irrational, right. But, yeah, I would, I would say thank you. I would, I would say this. And I think it could work the same way and ties into what we said earlier about, people are making bets probabilities. So think probability bets about the future think probability bets in terms of a spread, right? And so let's go back to the car companies when they first came out for GM, etc, etc. I think there were a hundreds of car companies, right? The total addressable market, if everyone in the US bought a car, imagine that right? The total addressable market, I don't know to make up a number, let's just say $100 billion. I have no idea that's even tied to reality back then. But that's it probably isn't actually. But let's just say $100 billion to make the math easy, right? There are there are 1000 car companies. People don't equal weight, the probability is that everyone is going to win, right? But they say, okay, Ford has a 30% chance. GM has a whatever 10% chance. I don't I don't I don't even know what car companies are 9% chance Yeah, Studebaker, whatever, you know, I, etc, etc, etc, right. And so those things, though, don't add up to 100, it could be beyond it up to 100%, it could be beyond 100%. Because it could be a winner take all component, it could be this or that. But the point is that they're betting the probabilities that these particular companies even the dot coms are going to hit that total addressable market, and there's only a few winners, right? And so they're betting that and that's why it goes up like crazy, because this is to your point, Bob, they're betting on the probability that this is going to happen. And if my company wins, which I have a 20% chance of this, you know, and you tie it to the billion dollar market cap, then it's gonna be worth $200 million, you know, that kind of thing. But as as news comes in every day, and news comes in fast and furious, sometimes when it becomes obvious, there's only gonna be two winners, and it's only going to be these two winners. Everything pops for the other ones. It's like the day after a game. Day after game, there are no more bets for the previous day, you know, I mean, they're they're already in there done. No one's gonna continue to bet it. No one says the bubble crashed on Sunday night football. No, it's It's over, you know, it became known the outcome became known. So everything recalibrates

Bob French 48:44
That's a really important point, that a lot of bubbles, a lot of what we talked about as bubbles are really hindsight. You know, these are still the same people, you know, in 2003, it was still the same people as the people bidding up the prices in 1999. You know, they thought they were doing what made sense at the time. And it's only by looking at it after the fact that we can really say, yeah, that was done. You know, we shouldn't have valued risk that way, you know, we shouldn't have no, everyone should have known him. Studebaker was gonna go out of business. So that was dumb. Why? Why would we have done that?

Alex Murguia 49:24

Yeah, but at that time, you were playing a 10% chance of success in a total addressable market of $100 billion. So, hey, that's what he's working on. Demand elbow times. Yes. So that's, that's how I kind of, that's what I can hang my head on. When I think about bubbles in terms of sure there's some enthusiasm on it, but I still think they're pricing probabilities, you know, for total addressable market, if there's this new sort of thing that's out there. You're gonna see that now with AI, right? They're effectively saying, you know, every few years, you know, there was the internet there was mobile. Now this sort of is a generational thing, right? And there's going to be companies now that are going to sprout up because the funding for InVenture for that kind of company is very hot right now. So you're gonna see hundreds of these companies pop up, they're gonna figure out what the total addressable market is for this kind of seismic shift paradigm, if you will, and people are gonna place their bets, knowing full well, that not that 500 of these new company, they know that 500 of the newcomers are not going to succeed, but they're going to take their bets, you know, based on the probability that they will succeed, it's going to lift all ships, but then as the music starts playing, you know, chairs start being removed. Absolutely. That's, that's, that's, that's my thing. That's what I'm seeking to. Wade

Wade Pfau 50:50
It's not a bubble.

Alex Murguia 50:53
Well, I don't know. I mean, look, we're talking here, because we're opinionated folks. And we're kind of not hedging what we say this or that, you know, who knows, I'm willing to be wrong, right. But ultimately, that's, that's, that's a kind of a, that's something that aligns with everything that I know. And I've been a net I've learned with regards to investing, you know, and the philosophy that I subscribe to, which, in my from my vantage point is the most empirically sound, you know, you can make the case capitalism, right. It's a great system, even though it's terrible, you know, it's the best one we have,

Bob French 51:30
No, I come at it from a slightly different take that people can be really, really dumb. It's just, I'm a person. And I don't necessarily know when someone's being dumb. It could be, you know, when we're looking at these prices coming up. Maybe they shouldn't be this high. I don't know. And it's only by looking back after the fact we can say, yeah, that was done. The prices shouldn't move like that. But when the available information at the time with how people were reacting to that information, people were paying those prices. And I don't know, I don't know how to systematically say, or even on a case by case basis, say this isn't real. And until I can do that reliably, it's irresponsible to try and guess.

Wade Pfau 52:24
So maybe they just wrap things up, then we could be a little more explicit on the idea that if you're not going to market time with what's the alternative? What are you? What are you supposed to do?

Bob French 52:35
the alternative is kind of be boring, you know, don't market time is to build your systematic entirety of your retirement income plan around where it is that you want to go and build a portfolio, build an investment portfolio, that helps you towards that point, that helps you reach those goals, and then stick with it.

Wade Pfau 53:02
So invest when you have the money available, sell when you need the money to spend, and don't get caught up in trying to say, Oh, maybe I should wait another week before I invest, because I think the markets about to go down. If you've got the overtime markets tend to go up. And so time in the market, if you have funds to invest, go ahead and get it in the market. And don't don't try to time those decisions,

Alex Murguia 53:26
Your role as a price taker. And, you know, you're it goes back to yesterday, it goes back to the last three episodes. Last week I met which is like, listen, accept market returns and harvest those gains, you know, you're on the coattails of capitalism. Try not to be too cute by half by timing by using technical analysis. And frankly, fundamental analysis is is it's not bad. It just doesn't serve you in the way you think it does. It serves the passive investors. So I thank you for your service. But you know, for doing that, but you know, and again, we've the last three episodes, we just said it conceptually. In the next one, we'll go over the numbers. Because to your point, if it works, then I'll be able to show you look at all these technical analysis people that have succeeded, look at all these fundamental analysis people that have succeeded, look at all these successful market timers. But with a caveat and wait alluded to today earlier, more than what would be predicted by chance. Because yeah, I can point out to people that have been well that have done well. But that doesn't mean anything unless I can point out to more people, then then what would have been predicted by chance than a random sample would have succeeded. And we'll get to that in the next episode.

Wade Pfau 54:55
Okay, thanks everyone for listening and we will catch you next week with me. Look at the The actual performance of investors over time

Alex Murguia 55:07
Take care everyone.

Bob French 55:10
Wade and Alex are both principals in McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with risk including risk of loss. Past performance does not guarantee future results.