It's Time to Invest!

HINDSIGHT… RETROSPECT… 20/20 VISION… MONDAY MORNING QUARTERBACKING…

When you have money to invest, don't you wish you knew when would be the best time?

Looking back, 2017, for example, would have been a great time to invest, with the Dow setting 76 record breaking highs. Right?

Right, but just for the sake of argument, let's go back to January 2017. The market outlook was okay but not great. The long-running market rally in U.S. stocks was in its 8th year – one of the longest-lasting market rallies in history and long overdue for a correction. In January 2017, you could have made a good case for not investing in the stock market. The law of averages did not appear to be in your favor. If you had cash to invest on January 1, 2017 and did NOT invest or if you pulled out of the market in anticipation of a pullback, you would have missed a banner year.

Meanwhile, the S&P 500 was up 21.7% in 2017 - just another example of why market timing doesn't work.

Fast forward to now, the fundamentals look good, but again, the market is still at a relative high point, and the average price-earnings ratio is currently 25.99—a bit pricey (the average P/E ratio of the market is about 14). Maybe you could have invested a few weeks earlier when a market correction was being defined as a 10% drop from its most recent peak. But you would have had to be watching closely, and no one realized that over half of that pullback would be recovered in the following weeks. With the Dow dropping over 1000 points in a single day, who would have known it wouldn't go down further?

Fact is: there's never a bad time to invest as long as you have a well-diversified portfolio and do not have "all your eggs in one basket."

In 1720, Sir Isaac Newton—arguably one of the smartest men who ever lived, lost 20,000 British pounds by investing in the South Sea Company stock at the top of the market. The oversold South Sea Company was founded in 1711. The common expression, "financial bubble," found its origin in this investment. When the bubble burst, thousands declared themselves ruined and banks failed because they could not collect loans used to purchase the inflated stock. It wasn't long before investigations into the scheme began. Newton actually sold his first investment for 7,000 pounds in April of 1720 with a 100% return. With the confidence gained from that transaction, he re-entered the market and ended up losing 20,000 pounds several months later.

They knew about diversification in the 1700s, but unfortunately for Sir Isaac, the idea wasn't perfected until 1952 when Harry Markowitz wrote a paper entitled "Portfolio Selection". Four decades later (in 1990) Markowitz was awarded the Nobel prize for his work.

In the past, diversification meant increasing the possibility of a loss or accepting a lower expected return (an either or possibility). On the other hand, the Markowitz theory on diversification in the 20th century was something entirely new, a finely tuned strategy defying the tradeoff that exists between two extreme possibilities.

By diversifying an allocation using a mix of invested assets with negative correlations to each other, an investor could afford to increase the allocation to higher returning assets with lower risk in the overall portfolio. Markowitz believed that an investor could accomplish 90% of their financial objectives simply by positioning their assets within these certain asset classes.

Thus, asset allocation and diversification based upon modern portfolio theory reduces the angst of when to invest or knowing how to time the market. In a well-balanced portfolio based on your financial goals and time horizons, it makes little difference whether you invest at a high point or a low point in the market. There are no guarantees, of course, but we know as Isaac Newton learned that market timing doesn't work. If you would like to learn more about asset allocation and diversification in investing, give us a call at H Financial for a confidential meeting.

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