1 of 1 DOCUMENT

The Press (Christchurch, New Zealand)

December 1, 2011 Thursday

Market timing hard to call

BYLINE: BIALKOWSKI Jedrzej

SECTION: FEATURES; GENERAL; Pg. 6

LENGTH: 777 words

Many mum-and-dad investors adopt a buy-and-hold strategy when it comes to shares and mutual funds. University of Canterbury economics and finance senior lecturer Dr JEDRZEJ BIALKOWSKI asks if that's a blessing or a curse.

'Oops! . . . I did it again" would seem to characterise the thoughts of those investors who now regret not selling their share and mutual fund holdings at the beginning of the 2008 financial crisis and then buying them back in the middle of 2009.

Such a strategy brought profits of 90 per cent and 44 per cent in S&P 500 and NZX 50 investments, respectively, between October 2007 and January 2010. After missing such an opportunity, individual investors promised themselves that next time they would act and benefit from stockmarket turbulence.

A few years have passed and mum and dad investors are asking themselves the same question: Should we sell our shares and mutual fund holdings now that Europe is in a debt crisis?

To shed some light on this dilemma, we need to evaluate the performance of the so-called "buy- and-hold" strategy versus active portfolio management.

The buy-and-hold strategy assumes that investors buy an asset with the intention of keeping it in their portfolios for a long period.

With an active portfolio management strategy, investors move their investments around in the hope that they can anticipate the market's peaks and bottoms. Investors who possess the market- timing ability are able to move money into mutual funds that represent asset classes or market sectors before superior performance occurs, and out of the sector prior to poor performance.

Academic and finance industry literature provides evidence that more trading does not necessarily lead to better performance.

A recent study by **Arvid Hoffmann,** Hersh Shefrin and Joost Penninng examined a large sample of online brokerage clients. The study revealed that nearly all equity trading strategies produced lower returns than the benchmark market. These strategies include trading based on technical analysis, which is very popular among investors.

The inferiority of such an approach is confirmed by the work of Ben R. Marshall, of Massey University, and his co- authors, that was published in the Journal of Empirical Studies.

This study shows that more than 5000 trades based on technical analysis did not add value beyond what may be have been expected by chance. On the other hand, one could expect that professional investors, such as those managing mutual funds, do have much better market timing.

Unfortunately, the mutual fund industry has a long history of trend-following behaviour. In other words, on average, fund managers move money into asset classes that have increased in value and take money out of asset classes whose value has recently fallen. As a result, a fund effectively buys high and sells low.

In an article by Richard Ferri, published in the Journal of Indexing, he estimated that such behaviour costs investors in terms of performance about 1 per cent per year. Furthermore, based on more than three decades of mutual fund performance studies, there's a strong consensus with regard to the inability of mutual funds to beat the market after all relevant fees are deducted.

The vast majority of these studies, however, have focused on the US mutual fund industry, which in terms of assets under management and holdings in the domestic equity market is far ahead of the rest of the world.

A study by Rob Bauer, Roger Otten and Alireza Tourani Rad has shown that the alphas of funds for New Zealand equity funds for the period 1990-2003 are insignificantly different from zero, whereas balanced funds underperform significantly. A fund's alpha is a measure of performance on a risk-adjusted basis.

The authors found no evidence of market-timing abilities by the local funds.

The Boston-based company Dalbar Inc has introduced the "guess right ratio" as a measure for investors' ability to predict a trend on the stockmarket.

The guess right ratio shows that the poor timing of a purchase or sale and fear have an impact on the return created by portfolio fund managers. According to Dalbar Inc, investors were right about the stockmarket's direction in 14 out of 20 years. However, they were mostly wrong in their prediction of the time of recovery after a bear market.

In summary, bad market timing can destroy the value of a portfolio.

On average, both individual and institutional investors are unable to create value via active portfolio management.

In other words, individual investors should not regret being inactive during periods of stockmarket turmoil, as almost surely they would not select the optimal time to buy or sell stocks.

LOAD-DATE: December 5, 2011

LANGUAGE: ENGLISH

PUBLICATION-TYPE: Newspaper