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DARE TO BE DULL

Should I get back into the stock market?

With the stock market up by nearly 40 percent from its lows during March, I'm getting asked pretty regularly if now is the time to jump back into the stock market. To which my answer is a resounding: "No!"

How, you might ask, can I give this advice without having a clue what the stock market will do during the next few months? I'll tell you how.

Those were dark times back during March. Every news report brought a declining Dow. As my clients watched this decline, and the corresponding shrinkage of their portfolios, they agonized about the daily setbacks.

What did this mean to their goals of financial independence? Were their dreams for retirement shattered? Would they need to substitute Alpo in the meat food group?

Back then, I was keeping my upper lip as stiff as possible and writing many "stay the course" columns. I did my best to point out that the new paradigm of capitalism being dead was every bit as silly as the paradigms in the Internet bubble, where cash flow no longer mattered; or the real estate bubble, where real estate prices could never decline.

Unfortunately, my assurances often fell on deaf ears. As the intense pain of financial loss reached critical mass, investors tried to turn off the pain by selling. Now those same people are asking whether they should get back in.

Predictably irrational

That it's better to sell high and buy low, is obvious with a capital "O." We're always looking for bargains, especially during this current economy. Yet, when it comes to investing, we do just the opposite. The chart (top right) shows when money pours in and out of stock mutual funds.

For most of my life, I've believed that timing the market was nothing more than an urban myth, as implausible as the poodle in the microwave story.

But now I realize I was wrong. We really are good at timing the market ... really badly. Chalk



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it up to our own fear and greed.

My research confirms that performance chasing has us underperforming the stock market by about 1.5 percent per year. Picture if you will that the stock market is a dog park: We're the dogs, and Wall Street is the one throwing the ball.

When it's a bull market like during 2002-07, Wall Street is yelling "fetch" and we're all chasing the "buy" ball. And when there's a plunge, like now, we're fetching the "panic and sell"

ball.

If you add the additional 2 percent penalty that the average investor pays in both stated and hidden expenses, then the costs of expenses and emotions total 3.5 percent. That's nearly all of the real, after inflation return that we might get from the stock market. I'm thinking now is the time to stop chasing that ball.

Believe it or not, this is the good news.

Remember, the 1.5 percent annual penalty for following our emotions represents the average investor. Investors that got out of the stock market or drastically reduced their exposure to equities since the October plunge are probably way above average and paying a much higher penalty for reacting to their emotions.

They also are likely to be paying more than 2 percent annually for expenses. Thus, they are quite unlikely to ever keep up with inflation and would be far better off in a low-cost bond fund or high-paying CD.

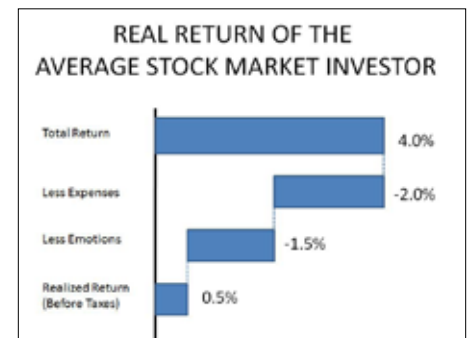
While some have said they've learned their lesson not to time the market and have a whole list of reasons why they did it this time, the terrible truth is that we investors have very short memories and tend to repeat our mistakes over and over again. We might have different reasons why we buy high and sell low, but we do it every time.

My advice

If you significantly reduced your stock holdings after the market plunge, you probably shouldn't get back in. If you did it at the advice of your investment adviser, you should

remember that investment advisers have been shown to performance chase every bit as much as individuals investing directly.

If you can embrace uncertainty and believe in capitalism, then broadly diversified, low-cost index funds should be part of your portfolio. If you have the guts to rebalance, buying after a plunge and selling after up markets, then you might share in the rewards from the emotional mistakes of others.



If you cannot accept the above, then finding the highest paying CDs or low-cost investment grade or U.S. government backed bond funds are probably the way to go. They are more likely to yield a greater return than buying a hot equity mutual fund in an up market, which is a recipe for disaster.

Allan Roth, a CPA and Certified Financial Planner, is the founder of Wealth Logic LLC, an hourly based financial planning and licensed investment advisory firm. He also is the author of "How a Second Grader Beats Wall Street." He can be reached at 955-1001 or at ar@DareToBeDull.com.