ADVISOR PERSPECTIVES

Market Timers in S&P 500 Pay a High Price for Perfect Prescience

March 23, 2021

by Lu Wang and Claire Ballentine

About $22 trillion of wealth was created in U.S. stocks, roughly the country's total annual output. An exchange-traded fund tracking the airline industry has more than doubled. At least 45 companies in the S&P 500 have surged by more than 200%, including Tesla Inc., up almost 700%.

A lot of things have gone right for stock bulls in the 12 months since equities bottomed after the Covid-19 crash. And there's a chance you would've missed it all if you somehow managed to sell with perfect foresight at the top.

It's an old observation -- don't try to time the market -- with particular resonance today, amid a rally that has pushed the S&P 500 more than 16% above its previous peak. That's the biggest increase of its kind ever recorded in the U.S. stock market at the first anniversary of a bull market.

In other words, missing last year's meltdown would've kept bulls from losing almost a third of their investment, but potentially at the cost of missing a particularly epic rebound.

"It's just a great reflection of how futile trying to time the market really is," said Elliott Savage, portfolio manager at YCG Investments. "You've had just such enormous stimulus and then this new cohort of retail investors come in and it's led to very surprising results that I don't think anyone, if they're honest with themselves, would've predicted."

The lesson may be of interest today, a reminder of the hazard of trying to call the market top, after the S&P 500 surged 76% from its 2020 trough. With stocks falling victim of bond market turmoil and President Joe Biden mulling tax hikes for corporate America, the case for caution is building.

Aging Bull

In Bank of America's latest monthly survey of money managers, 55% of the respondents viewed the bull market being in the late stage, up from 53% in February.

But the cost of acting on bearish hunches is often high. If you somehow happened to miss the five biggest up days in the S&P 500 over the past year, for example, your return since February 2020 turns negative.

"It's easy to get out of the market. It's difficult to come back," said Quincy Krosby, chief market Strategist at Prudential Financial. "We live in a much faster market. You don't have the ability to sit and wait and watch."

Compounding the challenge is a market whose volatility has stayed elevated, making each decision more dramatic. Scoring 103 sessions when the S&P 500 rose or fell at least 1%, the first year of this bull market has been wilder than all but two of the previous 13 cycles.

To be sure, thanks to the relentless rally, bears have been driven nearly into extinction. Warnings of a broad market crash that once dominated daily headlines have largely gone mute. Still, alarms are being sounded about certain areas, technology shares in particular.

Earlier this month, DoubleLine Capital LP founder Jeffrey Gundlach said the Nasdaq 100 may face a collapse similar to what it suffered during the dot-com era. At Wolfe Research, strategists led by Chris Senyek are closely monitoring bubbles in 10 areas, including the Nasdaq and special purchase acquisition companies.

With the economic outlook brightening amid vaccines, the rotation away from shares that benefited from the pandemic lockdowns to ones that should thrive as the economy bounces back has led to the biggest crash in the momentum trade in more than a decade.

"We went from a Covid crisis mindset to a reopening mindset," said Scott Knapp, chief market strategist of CUNA Mutual Group. "It was almost like a switch got flipped," he added. "Just deciding when to get in and when to get out is borderline a fool's errand."