WILLINK
ASSET MANAGEMENT LLC

October 2011 All *Stocks Half the Time or Half Stocks All the Time?*

This economy, this political season can make it harder for you to ignore the daily market news. It can make you question if "tried and true" investment strategies are good enough. We understand that, and want to hear your questions and concerns.

When all is said and done, you want to be in the market–BUT MAYBE NOT RIGHT NOW. The market goes way up way up one day and way down the next, but mostly sideways. You recall those admonitions to resist the urge to "Market Time"–moving some or all funds into, then out, and then back into the market again.

Maybe "Buying and Holding" a mix of stocks, bonds, and cash is no longer the best strategy. The long term seems awful long in coming. Perhaps you should reduce your exposure to stocks and increase it again "when things get better", in response to some short-term signal, or forecast.

You worry about a global debt crisis and continued recession. You wonder if there is still time to buy gold in anticipation of a coming economic collapse. The "Lost Decade" of near zero returns for large US stocks certainly doesn't inspire confidence.

So, is Buy and Hold Dead?

Investors in 2011 have witnessed almost unprecedented volatility. Daily ups and downs like this have rarely been seen since the 1970's.

It is no surprise, therefore, that market timing, the idea that one can track indicators to tell when it's safe to be invested in the stock market and when it's not, is being widely promoted once again. This would be in contrast to the long held wisdom of diversifying among stocks, bonds, and cash and pretty much sticking to that allocation. We have dubbed the buy and hold strategy "Half Stocks All the Time". Many advocates of timing pursue an all-in/ all-out strategy. We call this "All Stocks Half the Time"

It is easy to conclude that if one could avoid most market-loss days and catch most gains, market timing would be a worthwhile strategy. Meanwhile, you have probably seen mutual fund industry advertisements warning against the perils of timing.

It's fair to say the mutual fund industry has a vested interest in keeping you fully invested in their products all the time. That might be a non-disclosed reason for their warnings about timing.

However, Market Timing has also been discredited by a variety of academic studies. These focus on the extreme difficulty of avoiding those few perilous days when the market plummets, the difficulty of re-investing to catch those very few days when the market zooms upward, and the various costs (taxes, investment expense, unreliable indicators, bad timing etc.) incurred while trying to pull this off. That seems reason enough to avoid timing extremes.

Proponents of timing counter with "proofs" of their own, citing that success needn't depend on lightning fast reactions in and out of the markets, Instead, one need only avoid the worst of a plummeting market and need return only when the trend has turned positive. They say getting out at the very top or back in at the very bottom isn't required for timing to beat a buy and hold strategy.

Assume that you are not going to gamble all your money on one strategy or another. You will take a middle road by allocating half of your funds to a buy and hold portfolio of stock, bonds and cash. You will pursue market timing in and out of stocks with the remaining portion.

Think about this for the moment.

1) If timing works, why not employ it for all of your investments- why hold any bonds or cash?
2) Could it be that you might be uncertain about the outcomes with timing? Isn't that saying timing doesn't work 100% of the time, for one reason or another?
3) That being the case, how often do you calculate your timing calls will prove better than the more patient "buy and hold" strategy that is pretty much assured of earning you the average market rate of return? Will timing win 90% of the time? 50%?
4) Let's say your market timing activity is 65% successful, e.g., about two out of three timing calls beat buy and hold*.

**Two out of three calls correct? Critics of timing might say the timer is either really, really smart or really lucky.*

So, what might your portfolio result be versus an investor who relied entirely on a "buy and hold" allocation among stocks, bonds, and cash?

Actually, that depends–on several things.

It depends on the costs you incurred implementing your timing strategy. If you are a **technical trader,** following charts and looking for signals in the chart patterns, you may make many trades. That can mean big costs in commissions, research, taxes, and losses on spreads (by the time you act–the price you want has already moved away from you).

It depends upon your ability to **"connect the dots"**, among world and market events to forecast the future. We know one investor who believed correctly back in 2006 that we were heading for a financial crisis. He pulled out in early 2007. While he missed the continued rise in prices that year; he avoided the crash in '08-'09; but then missed the subsequent recovery. Who knows what the longer-term result will be for him?

It matters over what **time frame** you measure the outcome. Shorter term, you might feel good, and your portfolio can look healthier if you avoid a market crash. Now, all you have to do is figure out when to get back in, and with how much of your money. Longer term, even in this decade of ugly returns, that has been a harder call to make. By our reckoning, while only a few forecasters called the timing of the crash in 2008, fewer still called the dramatic upturn in the spring of 2009

Most of all, it depends on the **net aggregate timing benefit** once you tally your good calls against bad calls and compare the result to a more patient buy and hold approach.

We think your chance of making a disastrous timing call increases the more timing calls you make. Remember, the buy and hold portfolio moves higher simply as the market eventually moves higher over the long term. You would automatically prosper by staying invested. That can make timing mistakes very costly.

So, is it "buy and hold" or "market timing"? Like many slogans, both may misrepresent actual investment practice and pose an either/or choice that is unrealistic.

It's fair to say the way we manage your money involves some of both.

Yes, buy and hold implies patience, discipline and a hard to maintain long-term view. We advocate an allocation among stocks, bonds, and cash that is right for you, and only modify that allocation in response to a significant life event or major structural change, say in the tax code, etc.

While the mutual funds that make up your portfolio do not often change; and while they remain fully invested (holding little cash at all times), the investments within them are in motion. It's hardly the sort of frenetic motion found elsewhere in the investment world, but, as companies' risk dimensions change, e.g., from large company to small, or from value to growth etc., fund make-up is adjusted to maintain the fund's risk profile. Astute trading can minimize unwanted side effects.

When one portion of your allocation, say real estate assets, moves down sharply in value and falls below its targeted weight in the overall portfolio, we may **rebalance** by buying more, seeking to

take advantage of sale prices and to return to the target allocation. When an asset zooms in value, we may sell a portion, with hopes of locking in portfolio profits as well.

There will inevitably be investments in a losing position. In non tax-deferred portfolios, we may sell these to **harvest losses** that can later be used to shelter subsequent gains from tax.

If you send us new cash to invest over some agreed upon time frame, we may use **value averaging**, buying more on bad days and less on good days, in hopes of making volatility work for you, rather than investing it all at once.

When stock **valuations** appear to us to be near historical highs or lows, we assess how buying or selling may accommodate your financial goals. It may be more prudent that a client near retirement protect his nest egg than pursue a rising market. The recipient of a large lump sum of cash from the sale of a business or a life insurance claim may be advised to invest slowly, according to their risk preference, their goals, and our relative valuation of the markets.

All Stocks Half the Time, an extreme approach to timing, seems like a fool's errand to us.
Half Stocks All the Time**, plus the inclusion of activities that share aspects of "market timing", seems the better course by which to attain your financial goals.

***or whatever the proportion of stocks, bonds, and cash agreed upon as most appropriate for you.*

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