Is Market Timing Everything?

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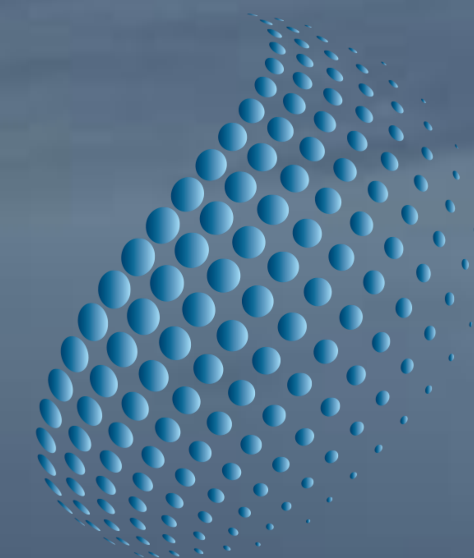

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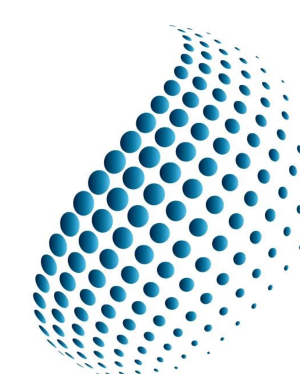
Global stock markets are trading at historically high levels, and many investors question whether this is the right time to invest in stocks. Logically, an investor would want to buy a stock at the bottom of the market and sell it when the market is high. Wall Street fund manager Peter Lynch famously argued that it does not matter whether you can time the market perfectly, and that investors have lost more money trying to avoid or prepare for corrections, rather than in the actual correction itself.

We will attempt to show that trying to time the market over the long term makes very little sense, as the overall effect of market timing for long-term investors is limited. As we will show, the difference between perfect and imperfect market timing in annual returns is negligible over time.

We can illustrate this with a similar exercise to Lynch, by imagining two investors who both invest USD 100 every year in the MSCI AC World Index since its inception in 1987 and up to the present. We simplify things a bit and ignore inflation, interest on uninvested cash, tax refunds on losses, or fees. One of the investors would time the trades perfectly and invest at the bottom of the market every year, while the other investor would be unlucky, and invest at the peak of the market every year.

The difference in annualized return for each year is relatively small, as you can see in the chart below. This illustrates that the effect of market timing for a given year is offset over time due to compounding. The exception to this is years of high volatility and hence large difference in the entry price level, such as the 2008 financial crisis and Covid-19 in 2020. In these years, it takes longer for the effect of compounding to mitigate the impact of market timing, but over a longer term, it should even out over the full period. The annualized difference is 0.7%, showing that market timing has little impact in the long run.



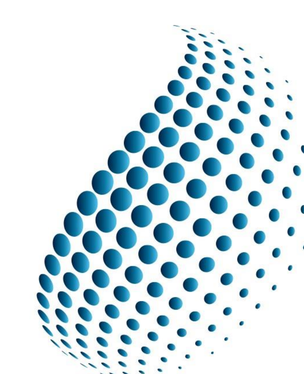
Annualized return

30%
25%
20%
15%
10%
5%
0%
-5%

1988 1991 1994 1997 2000 2003 2006 2009 2012 2015 2018 2021

High close annualized return
Low close annualized return
Cumulative annualized return

As illustrated, trying to time the market makes little sense for a long-term investor, as the effect of compounding mitigates the impact of market timing. If you are a long-term investor, you should not spend too much time worrying about the market, but rather spend time analyzing the companies you are invested in. Well-run companies that grow profitably over long periods of time create more value for an investor than market timing does.



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