DOW THEORY FORECASTS®

Time in the market

The *Forecasts* has been using the Dow Theory to discern the stock market's primary trend since we began publishing in 1946. The Theory itself goes back even further, with its origins credited to Charles Dow, the first editor of The Wall Street Journal, in the late 1890s.

The *Forecasts* has relied on the Dow Theory for more than 72 years because it does a credible job of keeping investors on the right side of major market moves. Mark Hulbert, a tracker of investment newsletters, writes, "the Dow Theory has been beating the market for an awfully long time." Hulbert cites an academic study from the 1990s that found that during the previous seven decades, the Dow Theory beat the broader market by an average of more than four percentage points a year.

While the *Forecasts* does consider the Dow Theory, we don't practice all-or-nothing market timing. A good example is our current allocation, which calls for an 86% to 89% invested position, despite the last indication from the Dow Theory being bearish.

Given the longtime efficacy of the Dow Theory, subscribers sometimes ask us why we hold any stocks when the Dow Theory is bearish. Short answer: The Dow Theory is not perfect — no market-timing tool is. And being wrong in an aggressive way, even once, can have a severe long-term impact on portfolio returns.

History shows that time in the market, not market-timing, has the greatest impact on building long-term wealth. Aggressive market-timing is difficult to do consistently over time, for at least two reasons. One, stocks have trended higher over time. Two, the market tends to post its largest gains in spurts, and you don't want to be out of the market during a spurt.

Consider the following statistics:

➤ Between 80% and 90% of the returns realized on stocks have occurred in less than 10% of the trading days.

➤ If you missed the best 10 market days in the 20-year period ending Dec. 31, 2017, a $10,000 portfolio would have risen to slightly more than $20,000. If you missed the best 40 days, your portfolio would have shrunk to around $5,700. And if you sat tight and held the S&P 500 Index for the entire period, your $10,000 portfolio would be worth more than $40,000 despite vicious bear markets that began in 2000 and 2007.

➤ The randomness of short-term market moves makes effective timing difficult. Since 1928, the stock market has risen in 54% of the days and 58% of the months. However, the stock market has risen in 73% of the years, 87% of all rolling five-year periods, and 95% of all rolling 10-year periods.

These and other statistics I could have presented beg the question — why market-time when you could stay fully invested in stocks at all times?

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Admittedly, you could do a lot worse than sitting tight through the inevitable ups and downs. However, the *Forecasts* believes incorporating time-tested tools like the Dow Theory in a prudent and measured manner can add value in several ways:

➤ Trimming equity exposure based on the Dow Theory can help soften the blow during bear markets. Our fully invested Focus List has gained 780% (9.6% annually) since its December 1994 inception. Adjusted for our recommended cash position, that gain improves to 837% (9.9%) despite a decrease in volatility.

➤ Building cash leaves investors better positioned to buy on pullbacks — and makes it easier to avoid panic selling at the market's lows.

➤ Incorporating the Dow Theory into an investment program can build discipline and consistency into your analysis process. Investors will do better by consistently applying a rational approach than by acting based on emotion. As our Editor and Director of Research Rich Moroney likes to say, "Having a system, even a mediocre system, and applying it consistently is better than having no system at all."

This idea of time in the market versus timing the market seems particularly relevant today, with investors hyper-sensitive to short-term market movements and a constant stream of headlines that push them to get into (or out of) stocks. If you feel the need to time the market, listen to the Dow Theory and make measured adjustments to your equity exposure. We discuss the Dow Theory regularly in our Market Commentary.

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