



## About the Firm

Lancaster Pollard Investment Advisory Group, an SEC-registered investment advisor, helps nonprofit organizations create the financial means to last the life of their missions by managing *total* financial risk rather than just investment-associated risk. Lancaster Pollard Investment Advisory Group shares common ownership with Lancaster Pollard, a leading provider of investment banking and mortgage banking services for the senior living, health care, affordable housing and private education sectors.



## The failure of “market timing” as an investment strategy

Whenever the public securities market witnesses extraordinary price volatility, most investors begin to question their investing discipline. While most non-professional investors are fearful of significant price swings, most professional investors embrace volatility as an investing opportunity. Both views, one half-empty, the other half-full, suggest that a change in asset allocation may be warranted because of the increase in volatility. Such an asset allocation procedure is known as “market timing.”

### Is it tactical or strategic?

The key distinction between the half-full and half-empty perspectives is that market timing for nonprofessional investors is not generally an asset allocation strategy, per se, but rather a maneuver in response to volatility seen in the marketplace.

For professional investors, however, market timing can be considered a tactical maneuver whenever it is employed under the guise of achieving certain strategic goals, an example of which might include a strategy known as “GARP,” or growth at a reasonable price. Fundamental analysis may suggest a

particular equity investment. Further study may prove that, while the equity investment may be compelling, the current price of the stock is still too high to be defined as “reasonable.” The portfolio manager would then watch the stock for a decline to the appropriate target price. Upon achievement of the price, one final review would confirm the desired inclusion of the stock in the portfolio as part of the GARP strategy. GARP managers generally look for opportunities in stocks that are temporarily out of favor. But that’s their strategy;

their discipline. GARP managers are not, by definition, market timers.

Is market timing ever a strategy, then? For a few professional investors, absolutely. But this article is concerned with non-strategic market timing. In the absence of discipline, market timing is normally a response to fear. The volatility seen in today’s securities markets has caused many investors to question their discipline. (Note that it is the volatility that generates the concern, not a search for a different tack independent of fear.)

**Only one investor buys at the very bottom, and only one investor sells at the very top. And it’s never the same investor.**

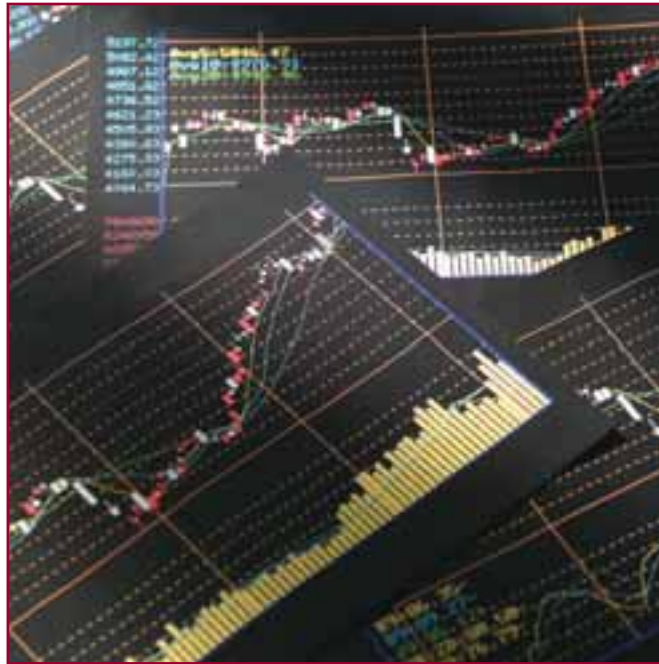
Is there risk to “being defensive” in a market wrought with volatility? After all, nonprofit investors cannot afford to sustain significant losses to hard-earned development dollars. Indeed, they have a fiduciary obligation to the assets under their care. There is a difference, however, in the responsibilities of a nonprofit’s management and its governance. Investment strategy is a governance issue.

A few very successful investors have weighed in on the value of market timing. John Bogel, founder of the Vanguard Group and the father of the index fund, wrote of market timing that, “after nearly 50 years in the business, I do not know of anybody who has done it successfully and consistently. I do not even know anybody who knows anybody who has done it successfully and consistently.” Peter Lynch once said, “I don’t remember anybody predicting the market right more than once, and they predict a lot.” Peter Lynch ran Fidelity’s Magellan Fund from 1977 to 1990, which was up over 2,700 percent in that period. Bogel was a passive investor, one who believed that the best way to invest was via an index fund. Lynch was an active investor. Both believed that market timing offered little value.

### Let’s look at the numbers

During the 15 years, from Nov. 30, 1992 to Nov. 30, 2007, the Standard & Poor’s 500 Index had an average annualized return of 10.63 percent, including reinvestment of dividends. There have been a number of volatile periods in the equity market in that period -- quite a few opportunities, in fact, for fear to overtake one’s discipline.

What if an investor decided to “time the market” and was unfortunate enough to miss the top 10 best-performing days of the S&P 500 Index in that period? In that 15-year period of over 3,700 trading days, that investor’s return would decline to 7.20 percent. Missing the top 20 days would reduce the average annual return over the 15-year period to 4.57 percent.



Does staying out longer have a more positive effect? Not if you missed the top 40 performing days of the S&P 500. Do that between 1992 and 2007 and your return drops to 0.32 percent, including dividends!

### Not a single point in time

As world economies expand and contract, as international pressures affect the stability of local currencies, equity markets will naturally move up and down.

Forecasting the effect that negative events will have on securities markets is very difficult. Calculating the magnitude of the resulting

market movement is even more difficult. Predicting the timing of negative events is virtually impossible. To be a successful market timer, one must accurately foresee each of these events. But market timing is not just about when to sell. It’s also about when to buy again. We like to say that only one investor buys at the very bottom, and only one investor sells at the very top. And it’s never the same investor.

### It’s about time in the market, not timing the market

As long-term investors, nonprofit organizations can tolerate a certain level of volatility in the investment markets. The recent declines seen in the markets should serve as a reminder, however, that volatility exists as markets move up, as well, providing a tell-tale sign that it’s time to review policies, procedures and practices. Fiduciaries are well served to maintain a constant vigil over the assets entrusted to them, in all market cycles. Such discipline demands, at the very least, that the investment policy statement has budgeted suitable risk relative to the organization’s financial health, and that the spending policy accurately reflects the sources and uses of the endowed funds. Only then can fiduciaries set strategies intended to optimize returns reflective of the mission of the organization, not the current market environment.