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Timing the Stock Market May Be Hazardous to Your Wealth

With the Dow Jones Industrial Average (DJIA) dipping below 7,000 and hovering around 6,500 the first week in March and talk about a further potential decline to 5,000, I received a few phone calls from anxious clients.

The question raised at the beginning of each conversation was similar, "Should I (we) be getting out of the market now?"

I initially reminded these clients about the fact that 20% - 35% of their portfolio, depending on their investment allocation model, was already "out of the market" since it was in money market and fixed income positions.

I then told them that if it would make them sleep better at night, they could sell a portion of their equity positions and park them in their money market fund. I cautioned these clients, reminding them that, to the extent they chose to do this, they would be deviating from their Investment Policy Statement since they would be engaging in market timing and its associated risks.

Market Timing Risks

Whether you realize it or not, by making the decision to sell a portion, or all, of your equity positions and reinvest in a money market fund after the market has already been beaten up, you are employing a market timing strategy.

In addition to realizing sizeable losses, there is a high probability that your future, as well as overall, rate of return will be much less than what it

would be if you simply did nothing.

With the DJIA down 53.8% on March 9th at 6,547 from its high of 14,165, on October 9, 2007 (17 months to the day), the potential for a lost opportunity resulting from sitting on the sidelines and missing a rebound is very real.

Learn From History

While history isn't necessarily a predictor of the future, when it comes to market timing, there are some long-standing valuable lessons to be learned.

If you take away one message from this article, let it be this: between 80% and 90% of the returns realized on stocks has occurred between 2% and 7% of the time. If you were out of the market during this small window of opportunity, your return was a fraction of what it would have otherwise been.

An American Century Investments study found that a \$10,000 investment in 1990 would have grown to \$51,354 in 2005 had you not done anything. However, if you missed the 10 best days, your investment would have been worth \$31,994, and, if you missed the 30 best days, you would only have had \$15,730, or 30% of what you would have had if you stayed the course.

Perhaps overshadowing the historical speed of recovery from market downturns has been the unexpectedness of turnarounds. When these events have occurred, Paul Revere wasn't riding across the land shouting, "The stock

market's coming back, the stock market's coming back!"

While it may not be the beginning of an ongoing trend, as an example and yet another reminder of the rapid and unexpected nature of a potential stock market rebound, the DJIA increased 677 points, or 10.3%, in just four days, going from 6,547 on March 9th to 7,224 on March 13th. Furthermore, this took place against a backdrop of record unemployment and the release of major negative economic reports.

Beware of the IRS Wash Sale Rule

One other caution I shared with those clients recently wondering if they should get out of the market is the often-forgotten IRS "wash sale rule."

If you sell a security at a loss, and buy substantially identical securities within 30 days before or after the sale, your loss will be disallowed.

Suppose you sold \$100,000 of stocks and realized a loss of \$50,000 on March 9th. After seeing the market increase 10% since the sale, you repurchased the same, or similar, securities on March 16th. Result: You will not be allowed to deduct any of your loss.

Conclusion

While it is certainly possible that the stock market will decline further before it finally bottoms out, remember that timing the stock market may be hazardous to your wealth.