# Tactical mistakes:

**Timing the market is hard — for everyone. Don't be fooled into thinking you have the key. Believe me, I get it.**

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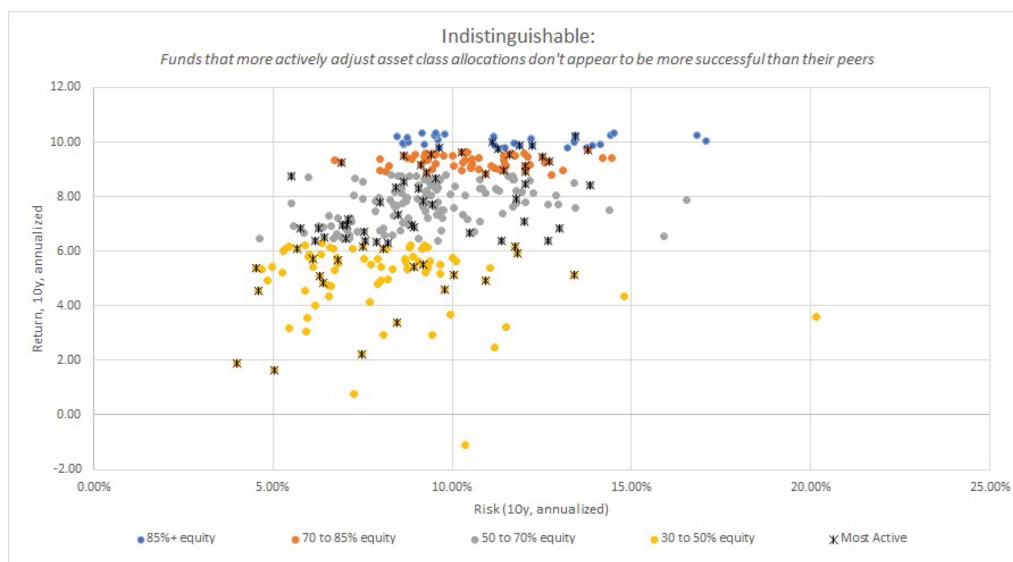
- You might be tempted to adjust your portfolio's asset allocation amid worries that stocks are nearing a peak, but the risk of making a mistake is high — even for professionals.
- Retail investors are far better at seeing what's behind them than what lies ahead (and some market participants even view overly bullish retail sentiment as a contrarian indicator).
- Institutions seem to be less inclined to "bull up" as markets rise, but there is scant evidence that they're much better at anticipating the future than retail investors.
- The performance of fund managers who more actively adjust their funds' asset allocations are largely indistinguishable from their more strategically oriented peers.
- Before doing anything rash, step back, take a deep breath and remember: One tactical mistake can derail even the best strategic asset allocation.

There are tons of reasons to fret about the current state of capital markets. Here's my list: stock market valuations are stretched by almost anyone's yardstick, the robust post-pandemic economic recovery is showing early signs of a peak, and inflation — transitory or not — is clearly spiking. Meanwhile, the COVID-19 virus continues to mutate into new and potentially dangerous variants with an unsettling regularity, threatening to force a return to the lockdown measures that clobbered global economic activity in the first place.

So the temptation to adjust your portfolio's asset allocation in advance of what could prove to be a very volatile autumn is real. But before you do anything rash, hear me out. If you've been investing for any length of time, you've almost certainly seen marketing pieces from various investment firms that point out the dangers of trying to "time the market," or reallocating ahead of a predicted drawdown in stock prices. These pieces, which are as colorful and ubiquitous as fallen leaves in a New England October, are designed to make you stay put amid the turmoil by pointing out that those unfortunate souls who reallocate away from stocks while markets are falling often regret the decision.




Source: Morningstar, GWI calculations (August 2021). Asset allocation, risk and return data 10 years ended June 30, 2021.

These ideas (which generally take a few common forms such as "asset class periodic charts," "don't miss the market's best days" and the like) are compelling enough that they've become staples of investment marketing — and, for what it's worth, I generally agree with the premise underlying them all. But the fact we're having this discussion now means they have perhaps fallen a little bit short of their stated purpose: imbuing investors with the courage to remain invested even when things look, um, unsettled.

Given that, I thought we'd take a slightly different approach and attempt to determine how successful investors of all types and differing levels of expertise — from retail DIY-ers to institutions and professional asset managers — have been at trying to time the market. (Spoiler alert: not very …)

**Retail investors: Better at seeing what's behind them**

Let's start with retail investors. For decades, the American Association of Individual Investors (AAII) has asked its members every month whether they were "bullish," "neutral" or "bearish" about the future direction of equity markets.[1] This high-quality survey has been the subject of analysis for decades and provides a fascinating peek into the minds of self-directed investors. But what may (or may not) be surprising is the disconnect between retail investor views as captured by the AAII survey and the future, near-term direction of markets. So weak is this correlation, in fact, that some investors view overly bullish sentiment in this survey as a contrarian signal — that is, evidence that markets are set up for a fall. While I'm not willing to take things quite that far, our own work nonetheless suggests that individuals are far better at seeing what's behind them than what's in front of them. Bullish views seem to display a slight tendency to rise during months when the S&P 500 Index rises, but there seems to be little connection at all between changes in bullishness and market returns over the next several months. Said another way, individuals seem to be reacting to current market returns rather than predicting future ones.

**Institutions: Less likely to "bull up" when market is rising but still not great at looking forward**

Again, that may not be altogether shocking. After all, retail investors usually have other things to worry about than forecasting the direction of markets (raising a family, maintaining a full-time job, making sure the dogs are fed and so forth). But what about people who do this stuff for a living? If retail investors can be forgiven for a relative lack of foresight, wouldn't it be reasonable to hold institutional investors to a higher standard? Thankfully for us, State Street Global Investors — a large financial institution with unique access to actual portfolio data for an enormous slice of the institutional investment market — compiles its own superb data set that, at least in spirit, runs somewhat parallel to AAII's retail survey in that it attempts to measure how bullish or bearish investors are but also captures the attitudes of large institutions.[2] Perhaps discouragingly, these investors don't seem to be a whole lot better than the AAII's DIY-ers in forecasting the future direction of markets. While institutional investors may no longer tend to "bull up" while markets are rising, bullish overall positioning within institutional portfolios appears to us to be no better at forecasting future near-term returns than rising bullishness among AAII's retail investors.

**Asset managers: Active asset allocators largely indistinguishable in risk-return space**

But what happens if we move one step higher on the investment food chain to asset managers, who are paid to invest other peoples' money? Here things get quite a bit trickier. There are no surveys or indices — at least none that I'm aware of — that take inventory of how these funds are positioned along the bull/bear spectrum across time, let alone how successful they've been with those views. That means a little more legwork is required, so we looked at historical asset allocation data for four broad categories of asset allocation funds in Morningstar's database, scanning for those who appeared to be more active than their peers when tweaking their allocations to stocks, bonds and cash across time.[3]

Once again, there is little evidence that actively changing your asset allocation in response to real or perceived shifts in the market environment is really all that rewarding — even for these paid professionals. In fact, the "active allocators" identified by our methodology are largely indistinguishable from more "steady-Eddie" funds in the risk-return space. (Notably, though, there is some limited evidence that "active allocators" in more conservative funds have been slightly more successful at reducing risk than their less active peers.)

So what's the point? While far from comprehensive, our data seems consistent with the often-repeated theme that investors who try to anticipate broad market trends by reallocating their portfolios across asset classes are unlikely to be successful. And that warning seems to apply to all investors, novices and professionals alike.

### Does a more active asset allocation lead to better outcomes? ... Maybe not.

| Category: 30-50% equity | n | Return | Risk |
|---|---|---|---|
| Most active allocators | 20 | 4.8% | 7/.9% |
| Universe (ex-most actives) | 65 | 5.0% | 8.0% |
| **Category: 50-70% equity** | **n** | **Return** | **Risk** |
| Most active allocators | 30 | 7.3% | 8.9% |
| Universe (ex-most actives) | 119 | 7.7% | 9.3% |
| **Category: 70-85% equity** | **n** | **Return** | **Risk** |
| Most active allocators | 14 | 9.3% | 10.8% |
| Universe (ex-most actives) | 48 | 9.3% | 10.5% |
| **Category: 85% - plus equity** | **n** | **Return** | **Risk** |
| Most active allocators | 6 | 9.9% | 11.6% |
| Universe (ex-most actives) | 30 | 10.1% | 11.6% |

*Data: Morningstar, GWI calculations (August 2021). Asset allocation, risk and return data 10 years ended June 30, 2021.*

While the temptation to act preemptively by tactically adjusting your asset allocation ahead of perceived market volatility may be real, it's worth remembering that even seasoned professional investors have historically had a hard time getting the timing exactly right. Before succumbing to temptation, step back, take a deep breath and remember that a poorly timed tactical mistake can derail even the best long-term asset allocation strategy.

1 Aaii.com. For AAII's own view about the tendency of some investors to view its survey as a contrarian indicator, see aaii.com/journal/article/is-the-aaii-sentiment-survey-a-contrarian-indicator?

2 Statestreet.com/ideas/investor-confidence-index.html. One essential difference between the State Street index and the AAII survey is that State Street's data measures actual portfolio allocations rather than investor attitudes toward future market returns.

3 Using 10 years of quarterly data in Morningstar's Direct database, we identified those funds whose allocations to equity, bonds and/or cash move more often (with allocations of at least one standard deviation higher) than their peers. These funds were flagged as "most actives" within their categories.

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