On The Mark

CAPSTAR FINANCIAL

Should you invest at market highs?

Key Takeaways

- With stock markets at all-time highs, concerns about an impending crash is a recurring theme that keeps investors with cash on the sideline.

- History shows investing—even at market peaks— has generated strong positive returns for long-term investors. In short, time is money.

- Data shows that lump-sum investing is a more efficient approach to building wealth over time. However, dollar-cost averaging may be a reasonable strategy for investors who might stay out of the market altogether due to fears of a large downturn after investing a lump sum.

Investors have learned the adage of buy low and sell high, but with stock prices at all-time highs, investors with money on the sideline wonder, should they still invest and if so how?

The investing journey comes with ups and downs of a normal market cycle. While there are always risks involved with any investment strategy, having a longer-term perspective provides the greatest safety from market sell offs. A look back at the returns when investing on the peak day before the market turned, shows the chances for positive returns are strong over the long-term, even if one started the investment on the worst possible day[1]. However, investors bear greater risk for negative returns in the short to intermediate term.

Investors citing potential for near-term negative returns as the reason for holding onto cash are betting the pullback will make up for the lack of return from staying in cash and also that they will be disciplined to put the money in when everyone else is selling during a bear market. Rather than trying to predict the peaks and valleys of market returns, investors should recognize it's important to stay invested for the long run as markets spend more time rising than falling. In short, time is money.

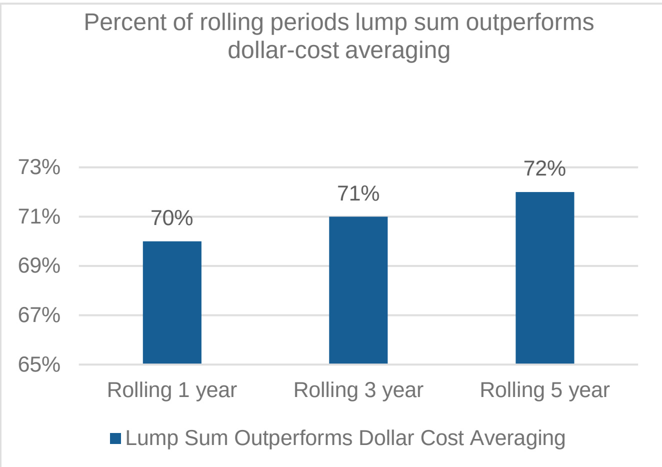
If you invested in..	Subsequent Crash	5 Years	10 Years	20 Years	30 Years
September 1929	-86.2%	-61.5%	-39.8%	45.3%	851.2%
March 1937	-54.5%	-36.1%	48.0%	637.4%	1969.1%
November 1940	-34.5%	101.7%	218.3%	1288.0%	2898.9%
November 1969	-36.1%	-9.8%	57.2%	712.1%	4084.5%
January 1973	-48.2%	-1.0%	91.0%	756.1%	1991.6%
October 1987	-33.5%	53.9%	295.4%	647.3%	1431.1%
March 2000	-49.1%	-4.8%	-3.0%	219.2%	n/a
October 2007	-56.8%	5.4%	104.9%	n/a	n/a

Source: Ritzholtz Wealth management. S&P 500 returns through 11/30/2020

That leads to the next question for investors with cash to invest; whether it's better to invest it in a lump sum or space it out over time by investing in regular intervals such as monthly or quarterly using a strategy known as dollar-cost averaging (DCA).

According to JPMorgan, lump-sum investing has been consistently proven to outperform DCA. They compared DCA to lump-sum investing on a rolling one, three- and five-year basis over the past 20 years and found lump-sum investing outperformed DCA over 70% of the time over each rolling year period[2]. The simple reason for this is that markets go up more than they go down. In fact, 66% of all monthly S&P 500 returns going back to 1990 have been positive allowing lump sum investing to consistently outperform.

So why would investors consider dollar-cost averaging if research shows otherwise? For many investors the thought of putting all their cash in the market at once may seem too stressful and possibly lead many to not invest at all. In short, DCA helps investors remove the emotions from investing.



Source: JPMorgan. S&P 500 total return index from 9/1990 to 9/2020. Rolling returns assumes over the first 10 months, 10 payments of $1,000 are made at the beginning of each month for each rolling period, and grows with the market for the remainder of the period.

When the market sets new highs, it is tempting to delay investing and wait for markets to settle down. For investors this requires knowing when the crash is coming, and to choose a market low for when to invest, a challenging task for any investor. Instead, history shows markets over the long-term go up more than down. For long-term investors, studies show it's still beneficial to continue investing even at market peaks. Finally, whether you invest a lump sum or spread it out using dollar-cost averaging, it's best to establish a plan and stick with it.

[1] https://awealthofcommonsense.com/2020/12/what-if-you-only-invested-at-market-peaks/
[2] https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/market-updates/on-the-minds-of-investors/does-dca-provide-better-returns-than-a-lump-sum-strategy/

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