Whether it comes from playing this game a few times, or investing in real life, the experience of investing teaches us important lessons about the dangers of market timing. (UBS)

Time in the market is better than trying to time the market

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Market volatility can be overwhelming, leading some investors to head for the exits and sit in cash. While this seems like a prudent way to reduce risk, it usually does the opposite, turning temporary losses into permanent losses.

In our **interactive "Market timing" simulation**, the UBS Chief Investment Office (CIO) provides a way for investors to learn about market timing, without risking real dollars. The tool is simple—over a two-minute simulation, you can choose between investing your cash or waiting for a better buying opportunity. You can buy and sell as often as you would like, and at the end of the simulation your results will be compared to a simple buy-and-hold investment return.

Whether it comes from playing this game a few times, or investing in real life, the experience of investing teaches us important lessons about the dangers of market timing:

Market losses are rare, short-lived, and impossible to reliably predict.
Usually the stock market is like a runaway train, making new all-time highs and rarely revisiting old levels. When a large drawdown occurs, the cause-and-effect logic often seems obvious after the fact, but this is an illusion. Because of a behavioral bias known as hindsight bias, we often think that in the past we predicted the present, and therefore we convince ourselves that we can predict the future. This bias comes in part from the fact that we often struggle to remember our failed predictions. There is never a shortage of things to worry about, but we often forget that we even worried about risks that never materialized, which is why we often joke that many doomsayers have predicted 10 of the past two bear markets.

Bear markets offer a rare chance to buy at "yesterday's prices."
Bear markets (episodes where the S&P 500 falls more than 20%) are a category that captures all the largest drawdowns in history. These are historically the only times that markets offer an opportunity for investors to buy stocks at levels that haven't been available for several years. Based on data from the **Bear market guidebook**, bear market drawdowns have temporarily "erased" about five years of bull market gains, on average. In other words, at the bottom of a bear market drawdown—a fleeting moment that only happens about once a decade—you may get one last chance to buy at the prices that you would have seen five years ago.

Market timing doesn't add value unless everything goes right.
In order to add any value versus a buy-and-hold strategy, you would need to sell high *and* buy low with the right timing. If you sell too early or buy too late, you risk missing out on gains that vastly exceed any potential market-timing profit you might have hoped for. The window of opportunity for buying near a bear market trough is limited—historically, it has taken about one year for a bear market to reach its trough, and two years from the trough until stocks are setting a new all-time high. Outside of bear markets—which are rare, occurring about seven years apart, on average—almost all market sell-offs are so short-lived that would-be market timers are left with proverbial whiplash (and often regretful that they didn't buy the dip!).

Diversification changes the game.
In our simulation, the investor's choices are either "all-in" or "all-out" and the only investment choice is the S&P 500. It's fortunate that these aren't the choices that investors have in real life. A balanced portfolio—e.g., 60% stocks, 40% bonds—has historically produced growth that is far more durable and reliable than a 100% investment in stocks: shallower drawdowns, faster recovery times, and more durable bull market gains. Because of these characteristics, trying to time an investment in a diversified portfolio would be even more difficult—and even less rewarding—than trying to time an investment in stocks. Therefore, when you have excess cash to put to work, having a diversified portfolio should help to reduce the allure of market timing.

There is a saying among professional investors: "Time in the market matters more than timing the market"

While market timing can be tempting—both for investors looking to boost their returns and those looking to limit their losses—its imagined benefits are ultimately a mirage. The phrase "buy low, sell high" may sound clever, but it has historically proven to be a fallacy because investors tend to overestimate how much they stand to gain from market timing, and tend to underestimate the cost of waiting for a pullback. Portfolio losses can only become permanent if you are forced to sell before the market recovers. By contrast, missing out on potential gains tends to produce much more sizable and permanent losses.

If you have excess cash that you can invest and leave invested for at least three to five years, and you are adding to a diversified, balanced portfolio, your best chance is to put the funds to work quickly. Talk with your financial advisor about strategies that can help you put cash to work with less risk of bad timing.

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Click here to take the quiz: How well can you time the market?

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