Avoid The Investor Trap

By Chuck Carlson, CFA
CEO, Horizon Investment Services

Some of the biggest market crashes of all time have occurred in the fall.

The world is on fire, with the war in Ukraine and Russia showing no end in sight and the hostilities in the Middle East expanding.

This election and its outcome has the potential to inject lots of volatility into the markets.

The stock market has done extremely well in 2024, which could mean it is ready to tumble.

Time to sell stocks, right?

Welcome to the Investor Trap.

". . . the temptation is great to lock up profits and move to the sidelines."

Indeed, there is much for investors to worry about these days. And I'm sure the temptation is great to lock up profits and move to the sidelines.

However, before you fall into the trap — and perhaps permanently impair your investment portfolios and retirement planning — consider the following:

Seasonality Is Not An Investment Strategy

Pundits love to write that the fall is not always a great time for stocks. Historically, that is true. However, September — which is historically the worst month for stocks — was actually decent this year, and October — the month in which big market crashes have occurred (the market crash

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of 1929, "Black Monday" in 1987) — was not a scary month for investors.

Bottom line — Investors who sell due to market seasonality, in our opinion, may be making a big mistake. Indeed, even if seasonal tendencies hold in a given year, trading out of the market to avoid a potentially minor decline, in our opinion, just doesn't make good investment sense.

Market Often Shrugs Off Global Hostilities

The 24/7 news cycle has a way of creating uncertainty and fear in the hearts and minds of investors, especially when it comes to wars and global hostilities. However, while we don't want to minimize the anxiety created by these developments, we don't believe it is a good idea to make investment decisions based on global strife. If you look at some of the biggest geopolitical events of the last 85 years, the market has been fairly successful in weathering the volatility and recovering short-term market declines.

A recent example is the Middle East. Since the initial unrest in the Middle East and the broadening of the conflict, both the S&P 500 and Dow Industrials have been making a series of all-time highs.

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Bottom line — Geopolitical developments may negatively impact markets on a short-term basis. But history shows the impacts are fairly short-lived. And trying to trade around the short-term impacts will likely prove difficult.

Election Investing Does Not Work

History has shown it has been a loser's game to anticipate market returns based on what party wins or loses elections. Indeed, history shows that you can make or lose money regardless of the party in the Oval Office or in control of Congress.

I have followed the markets for more than 40 years, through several political cycles. And with each cycle, I hear from investors who feel they should bail on their investment program because of who is or is not elected.

We believe the three engines of stock-market performance are corporate profits, interest rates, and inflation. If the prevailing political winds have a huge influence on those three factors, then politics matters.

The problem is, you really don't know ahead of time how, if at all, politics will impact these three factors. Sure, you may *think* you have an idea, but at the end of the day, in our opinion, you'll likely be wrong.

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Bottom line — In our opinion, and as noted above, stock markets are driven by interest rates, inflation, and corporate profits, with the latter probably the most important of the three drivers. As an investor, set your focus on those three factors, not what party sits in the White House or controls Congress.

Look Forward, Not Backward

We believe a bad investment practice is to anchor on the past.

One part of the investor trap is that the market has done well this year and, therefore, is ready to pull back.

Basing future market action on the past is like driving a car looking out the rearview mirror. It is not a particularly efficient (nor safe) way to travel from point A to point B.

Whether the market rises or falls going forward is not dependent on what the market has done in the past. Again, we believe the drivers of sustained market moves are inflation, interest rates, and corporate profits. Those are the factors that will drive markets in either direction.

Bottom line — Do not fall into the trap of selling simply because your portfolio has risen this year.

Pain Avoidance Can Be Costly

One reason we believe the trap is so dangerous is that it is all about pain avoidance, and who doesn't want to sell and avoid the pain of a market decline. However, keep in mind every time you sell to avoid a market pullback, you are engaging in market timing. And we believe successfully timing the market over a long period of time is very, very difficult to do. Sure, you might get lucky getting out at the right time, but there's no assurance you'll get back into the market at the right time. And as I've often said, the biggest risk in the market, in my opinion, is not being in the market when it goes down, but being out of the market when it goes up. And frequent pain-avoidance trading, in our view, leaves you vulnerable to being out of the market when it rises.

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One recent study by JP Morgan Asset Management shows the dangers of short-term market timing. The study looks at the 20-year period from January 1, 2004, to December 29, 2023. The study highlights the impact of being out of the market during the very best days during that period:

"Time rather than timing, in our opinion, is the best approach for building long-term wealth."

➤ A $10,000 investment at the beginning of the time period grew to $63,637 if the investor stayed invested the entire time.

➤ If the investor missed the 10 best trading days during that 20-year period (presumably as a result of trying to time the market), the value would shrink to $29,154.

➤ If the investor had missed the 30 best days during that 20-year period, the investor's initial $10,000 investment would have grown to just $11,483 — or an annual return of just 0.7%.

➤ And if the investor had missed the 40 best days during that 20-year period, the investor would have actually lost money ($10,000 investment would be worth $7,898 after 20 years).

Bottom line — Time rather than timing, in our opinion, is the best approach for building long-term wealth. Indeed, studies show that missing even just a few of the market's best days — and investors increase their odds of missing those days the more they trade the market — can significantly diminish market returns.

Of course, everything written here doesn't preclude the market from falling. However, we believe there are reasons to be optimistic about this market:

➤ The Dow Theory, a tool Horizon has used for decades to help divine the stock market's primary trend — the trend that typically lasts 18 months or longer — is bullish.

➤ We believe those three main engines of sustained market moves — interest rates, inflation, and corporate profits — tilt toward the bullish side of the ledger.

➤ Plenty of buying power — over $6 trillion in cash sits in money market funds — is available to push equities higher.

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Nevertheless, we believe making short-term market predictions can be perilous. In our opinion, if stocks are to fall, it won't because of the elections . . . or because stocks have been strong and are ready to decline . . . or because of seasonality . . . or the wars in Ukraine, Russia, and the Middle East.

We believe the market will fall (or rise) based on those three engines — interest rates, inflation, and corporate profits.

Horizon Investment Services welcomes the opportunity to help individuals avoid the Investor Trap. If you would like more information about Horizon Investment Services as well as a **FREE** portfolio review, contact us directly at **(800) 711-7969** or **www.horizoninvestment.com**.

Charles Carlson, CFA, is CEO of Hammond, Indiana-based Horizon Investment Services. For more information on the firm and its various investment strategies, visit **www.HorizonInvestment.com**.

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HORIZON
INVESTMENT SERVICES

800-711-7969

email: CCarlson@HorizonInvestment.com