High Anxiety

Should You Invest at All-time Market Highs?

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Each time in our 33-year history the stock market has experienced a strong multi-year advance, we find ourselves regularly asked whether it makes sense to stay invested when stock markets are at all-time highs. It is an important and challenging question, and there is no right or wrong answer – every investor's situation is different. However, we can offer insights that may help you decide what is right for you.

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Past Performance

In October 1982, the S&P 500 Index reached 120-a new high. This followed the decade of the 1970s, a brutal time for investors characterized by recession, high inflation and oil shocks. The financial press and most investors did not trust it. Bonds were still more popular than stocks.

Step ahead to the crash of 1987. At the 1987 peak, the S&P 500 had reached 304. Investors who had been willing to remain invested through the new highs were nearly three times wealthier than they were five years earlier. Then the crash of October 1987 happened dropping the S&P to 216. Many investors fled the markets. But by April of 1989, the markets were again reaching new highs. The S&P peaked this time in January 2000 at 1,469. Investors who stayed the course were nearly five times wealthier than they had been at the 1987 market peak.

Virtually all of these gains came as markets were reaching new highs.

A cursory look at a long-term graph of stock markets shows they have gone up a lot over the last 100 years; for most of that time, the market was reaching new highs. There have been extended periods of choppy performance with little to gain to show for it. The decades of the 1930s, 1970s and 2000s come to mind. Yet in general, the stock markets spend most years reaching new highs. In fact, a recent study showed that the S&P 500 was at or within 5 percent of its prior peak 45 percent of the time-almost half of the time.

What drives markets higher? It's impossible to answer that without understanding what the markets represent: the value of the world's publicly traded companies. As an investor you become an owner of these companies, and perhaps the most important factor driving the value of these companies higher is increased corporate earnings.

Companies around the world work relentlessly to deliver their products and services better, faster and cheaper. They do this in an environment of continuous economic growth and increasing standard of living. Humans have proven remarkable at envisioning exceptionally useful and creative products and being able to bring those products to market. While the correlation is far from perfect, as corporate earnings increase, markets rise.

Looking forward

It is tempting to try to time the market: Buy when it's at its low and sell when it's at its peak. This is really easy to do... with hindsight. It is nearly impossible to do (and no one has ever been consistently successful) with foresight. Many investors try-and fail. In fact, one third-party think tank, DALBAR, estimates the average mutual fund investor receives less than half of the returns of the mutual funds in which he invests. Why? Because he buys them after they've has a few years of good performance and holds them through the mediocre years that follow- only to sell them and switch to last year's "hot fund" just before they post strong performance again. It is a classic form of buying high and selling low.

What should you do instead? Develop a long-term investment strategy and stick with it. For most people, their asset allocation is neither 100 percent stocks nor 100 percent bonds. Rather, it is a balanced blend of both stocks and bonds-stocks for growth and high-quality bonds for stability.

Most people are best served avoiding the temptation to time the market even when it's regularly reaching new highs. If you still feel compelled to attempt timing the peaks and valleys consider doing so with a smaller subset of your overall portfolio, maybe just 5-10 percent. While this piece of your portfolio is likely to underperform, if it helps you commit the remaining 90 - 95 percent of your assets to your long-term strategy it is a worthwhile endeavor. But most of all never forget this: It's the years of new highs that truly build wealth for the long-term investor.