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QUALITY FINANCIAL CONCEPTS

QFC's Insights

Date: January 15, 2018

Category: Investment Markets

Time to Invest or Sit on the Sidelines?

"2017 Brought 71 Dow Jones Industrial Record Closes"

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I think it is safe to say few investors would have predicted the Dow Jones Industrial 30, which closed at 18,332.74 on November 8, 2016, to gain 6,386.48 points and reach 24,719.22 by the end of 2017. A 34.8% move. Time and time again during 2017, newscasters reported the Dow closed at a new record high. For many, the report of a new high was the very reason to sit on the sidelines.

If I have heard it once, I have heard it a hundred times: '*I just don't understand the markets*' or '*investing is like gambling*'. Those who do not understand why the market moves the way it does often choose to invest elsewhere where the results may be more predictable. Others may believe with all the new market highs it must be time for a correction. Like following a run of ten red numbers on the roulette wheel, the odds of a black number must increase, right? Actually no, the odds of a red or black number are the same for every spin by the croupier, 47.37%. Even after 100 red numbers, the odds of a black number on the next spin are still 47.37%. In roulette, the conditions are the same for each spin, since there are still 36 numbers with half being red and the remainder black plus the two green 0 and 00; thus, the odds do not change. Where in blackjack, as each hand is dealt, the odds of a specific card coming up changes as the number of remaining cards shrinks.

Investing is clearly *unlike* the roulette wheel, as conditions and factors affecting the market continually change. So, is blackjack the better comparison? The answer is no. Where blackjack has a fixed number of decks and the odds change with each hand dealt, none of the conditions affecting the market are fixed and each day of trading is not like a hand of blackjack, as each day does not impact what might happen on subsequent days. Investing can be predictable, but not necessarily based upon odds. While factors constantly change and investing in 2018 is not the same as any prior year, there are trends which can still be used to predict results, like falling or rising interest rates, the change in gross domestic product (GDP), or the unemployment rate to name just a few. Understanding the cause behind most of the moves in the markets should reduce its similarities to gambling.

While some significant market moves may appear to be without rhyme or reason, most professionals can point to one or more possible causes. However, with millions of investors trading daily and each investing different amounts for different reasons, to know with certainty why the market does what it does is impossible.

Insights Continued:

For a single investor, buying $10,000 of a stock is insignificant overall and the investment will not create a trend for most stocks. Today there are funds, plans, and organizations which invest tens of millions daily, and investments of this size or larger can create trends or change the direction of the market. So, by knowing and understanding the many factors impacting our economy, the large funds, organizations, and corporate profits, many of the previous seemingly nonsensical moves may become understandable.

The U.S. economic conditions did not change after the Presidential election last November as interest rates remained low, inflation was immaterial or modest at best, and corporate profits were improving. Yet with the new Administration, many investors anticipated corporate profits to continue improving anticipating some of the promoted changes to occur resulting in millions purchasing new stock positions at ever increasing prices. Throughout 2017, the valuations of U.S. corporations continued to benefit from a reduction in regulations, improving economies around the globe, and the anticipation of lower taxes.

Now at the start of another year and after so many previous records in the markets, many may raise the question whether it is time to get out. New record highs do not lead to a decline in the markets. And corrections, as I have written before, are expected and generally occur annually although they cannot be predicted and represent at least a 10% decline from the recent high. Each investor should evaluate their own capacity for risk before deciding to stay in the market or to take new positions. For the start of 2018 and this market, economic conditions, interest rates, tax rates, and anticipated growths of other economies are factors which may drive the market values. Until these conditions start to decline, we may continue to see records set in the markets. Investing is technical, and decisions are often made with reams of information; it just seems like nonsensical gambling.