

Investors vs. traders

World equity markets have seen some sizeable moves in recent weeks: an interest rate hike in Japan triggered a 17% drop in the Nikkei 225 Index over just three trading days in early August, while news of fiscal support from the Politburo in China saw stocks in Hong Kong rise 28% over the last two weeks of September. Investors observing these shifts may feel tempted to quickly enter and exit the market to avoid major losses and capitalize on sharp rallies. However, despite the seemingly clear price movements, consistently predicting these swings is virtually impossible – even with prior knowledge of the news.

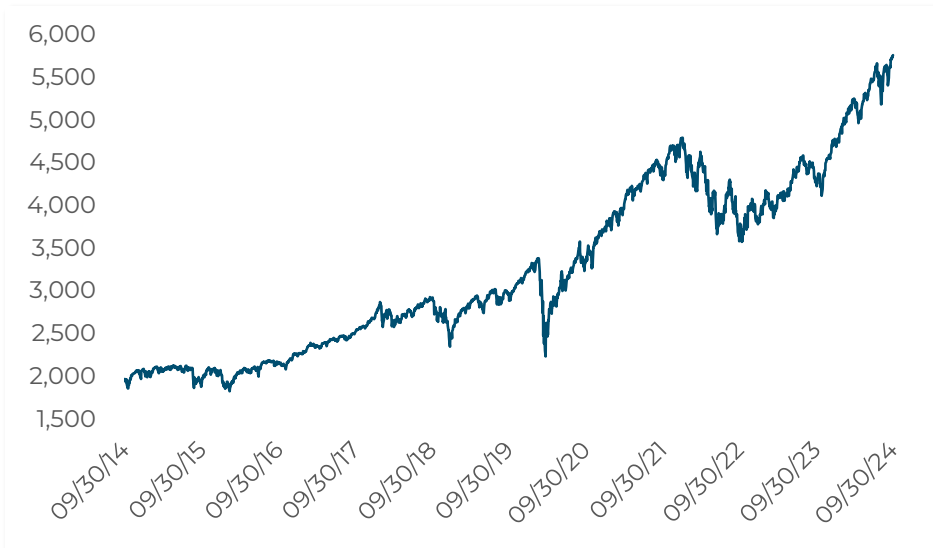
This challenge was highlighted in a recent Wall Street Journal review of an experiment showing people 15 randomly selected newspaper front pages from the past 15 years. Participants could read the entire front page except for any specific comments on the market action of the prior day. With this knowledge in hand, participants were free to bet, using a fictitious \$1 million sum, on the direction of stock and bond prices for the prior day. In other words, they were free to place bets on the market using front-page headlines a day in advance of their actual publication. More than 8,000 people participated, armed with this knowledge of the future. So how did participants fare in predicting market movements? The median wealth across all participants fell from the initial \$1 million balance to just under \$688,000 by the end of the 15 rounds.

How could this happen? The reasons relate to human emotion, the contrast of actual news to prior expectations, and the expected impact of this news on future events. As it turns out, the confluence of these factors, which incorporates views from a huge swath of investors, makes it exceedingly difficult to predict daily stock prices, even when you know the news in advance.

This view is supported by another simple observation, graphically depicted on the following page. For the ten years ending September 30, 2024, the Standard & Poor's (S&P) 500 Index (in US dollar terms) rose 11.3% in price annually, for a cumulative price gain of 192.2%, making for an excellent decade of market performance. Adding in dividends makes these figures even better, with the annual total return clocking in at 13.4%, and the cumulative total return for investors a robust 251.0%. However, for an individual focused purely on the daily moves, the picture changes considerably: of the 2,517 trading days over this ten-year stretch, only 1,353, or 53.8%, saw the market rise in price. The other 46.2% saw the market fall, suggesting that trying to predict daily market movements offers little better than a coin-toss for odds of success.

S&P 500 Index

(percent, US dollar basis)



11.3%

Annual price return

13.4%

Annual total return

53.8%

Percentage of days up

46.2%

Percentage of days down

Source: FactSet | S&P 500 index, USD price, 30 Sep 2014 to 30 Sep 2024

You wouldn't know it by glancing at the chart above, but investors looking to duck in and out of a marvellous bull decade for stocks faced almost equal odds of success and failure when trying to predict daily price swings. Even with perfect knowledge of the news to come, emotions and expectations make it virtually impossible to predict daily price action. When it comes to building wealth, investors are best served by focusing on time in the markets rather than trying to time the markets.

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