Investment Insights
Getting Invested

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Highlights

- Investing cash or new money in the stock market is always emotionally difficult, regardless of current market and economic conditions.
- Historical analysis shows that getting invested immediately is the preferred approach; for investors not willing to invest all at once, dollar-cost averaging over a short period (three to six months) is a reasonable alternative.
- We advise developing a simple written plan and sticking to it — and revisiting your target allocation if implementation feels too uncomfortable.

Getting Invested Is Emotionally Difficult

Investing cash or new money in the stock market right now *feels* precarious. After a challenging 2018, global equities have rallied so far this year to the tune of about 14%. It can be difficult to leave the sidelines and invest in a rising market given signs of moderating global growth and the ever-present risks of trade policy errors, central bank missteps, and exogenous shocks.

It is important to recognize that it never *feels* like the right time to invest money in the stock market. When the market has been moving up like it has recently, investors often feel like they are late to the party and have missed the rally, so they end up waiting for a correction or bear market to get invested. But what if that correction or bear market doesn't come?

When the market is moving down quickly, as it still was in the first few months of 2009, it feels like the downturn will never stop, and investors want to delay investment until the market bottoms out or appears more rational. But that is a tough proposition as well because it is usually darkest before the dawn, and market stability is really only observed in hindsight.

Our brains are hardwired to play tricks on us that make it always feel like now, whenever now happens to be, is the wrong time to invest! Whether the market has been going up or down, it is always emotionally difficult to get new money invested, and acknowledging that truth is an important first step in figuring out your plan for getting invested.

Different Approaches to Getting Invested

If we at Bessemer had a crystal ball, getting new money invested would be a piece of cake — we would simply wait for the low and invest then, or put everything in now if we knew the market run was going to continue. But timing the market is difficult if not impossible.

Many investors won't ever be comfortable putting all of their hard-earned money in the market at once. And while there are countless strategies for deploying money, one simple alternative is to invest incrementally over a set period of time, a strategy referred to as dollar-cost averaging. In the display that follows, we compare investing all at once versus three different dollar-cost averaging approaches (investing equally over three, six, and 12 months). We do this looking at the returns of the U.S. stock market over approximately the last 50 years, a period that included a lot of bull and bear markets.[1]

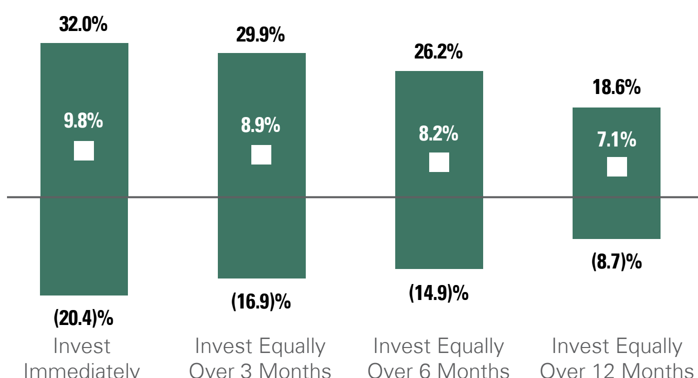
Results

As with many things in life, there is no perfect answer, definitely some wrong answers, and a lot of tradeoffs.[2] In Exhibit 1, the bars show the range of annual returns for different entry strategies for moving cash into the stock market. As you move from left to right and take longer to get invested, your return on average falls (as shown by the number in the middle of the bar, which is the median return). This is intuitive — the longer you are holding cash instead of being invested, the lower your return, since stocks outperform cash more often than not. Also, as you would expect, delaying entry has historically lowered your return in a big up market and provided for better protection in a big down market, as shown by the top and bottom of the ranges (defined as the top 5% and bottom 95% of outcomes over this period).[3]

Exhibit 1: Comparison of Getting Invested Over Different Time Frames (100% Stock Allocation)

Key Takeaway: As an investor takes longer to get invested, the average return falls. Delaying entry to the stock market has historically lowered returns in strong up markets and provided protection in strong down markets.

Rolling 1-Year Returns Since 1967



Data from January 1, 1967 to September 30, 2019. Returns reflect the total return. The final asset allocation is 100% stocks. Stocks are either invested immediately or equally over a certain number of months (for example, over 3 months, 25% is invested at the beginning of each month for 4 months, leaving the portfolio fully invested by the end of month 3/beginning of month 4). The remaining investment value that is not yet invested in stocks is assumed to be held in cash. The following indices were used to measure returns: S&P 500 (stocks), Global Financial Database USA Total Return Daily T-Bill Index (cash) until end-1980 and Citigroup 3-Month U.S. Treasury Bill Index thereafter. Data is monthly. Numbers shown reflect the 5%, median, and 95% outcomes.

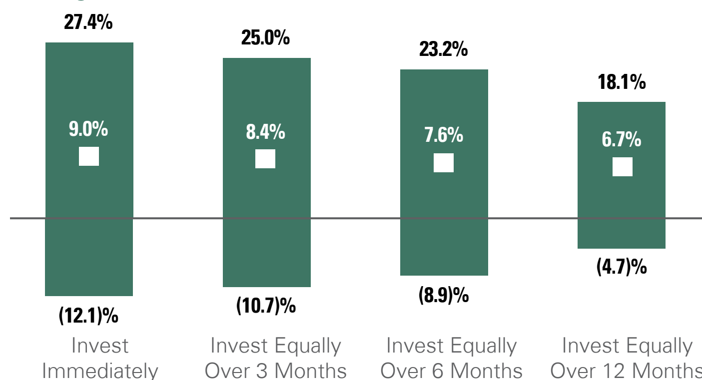
Source: Bloomberg, Citigroup, Global Financial Database, Standard & Poor's

Investing over 12 months cut the median return by 2.7% as compared to getting invested immediately, and it cut the upside from 32.0% to 18.6%. But in a really difficult market, your portfolio was down only 8.7% as opposed to 20.4% had you invested all at once.

Exhibit 2: Comparison of Getting Invested Over Different Time Frames (70% Stock, 30% Bond Allocation)

Key Takeaway: Versus a 100% stock allocation, the downside scenarios for a 70/30 portfolio are less pronounced for various entry strategies.

Rolling 1-Year Returns Since 1967



Data from January 1, 1967 to September 30, 2019. Returns reflect the total return. The final asset allocation is 70% stocks and 30% bonds. Bonds are assumed to be invested immediately. Stocks are either invested immediately or equally over a certain number of months (for example, over 3 months, 25% is invested at the beginning of each month for 4 months, leaving the portfolio fully invested by the end of month 3/beginning of month 4). The remaining investment value that is not yet invested in stocks is assumed to be held in cash. The following indices were used to measure returns: S&P 500 (stocks); Global Financial Database USA Total Return Daily T-Bill Index until end-1980 and Citigroup 3-Month U.S. Treasury Bill Index thereafter (cash); Global Financial Database USA 10-year Government Bond Total Return Index until end-2002 and Bloomberg Barclays U.S. Government 10 Year Term Index Total Return thereafter (bonds). Data is monthly. Numbers shown reflect the 5%, median, and 95% outcomes.

Source: Barclays, Bloomberg, Citigroup, Global Financial Database, Standard & Poor's

The Importance of Asset Allocation

The first study assumed that an investor was moving cash into a target asset allocation of 100% stocks. For most investors, however, their target allocation is not 100% stocks, and instead includes other lower-risk investments, like bonds. For comparison, we ran the same historical study — but this time using 70% stocks/30% bonds as the target allocation.[4] When we do that, the relative length of the bars is similar to the first study, but the numbers are quite different (Exhibit 2).

Now that the target allocation includes a healthy dose of bonds, the downsides are much less pronounced for all of the different entry strategies. Dollar-cost averaging did again improve the performance in very difficult markets (and hurt the performance in strong up markets), but the prospects of investing all at once are less daunting. In comparing investing all at once versus staging in over 12 months, is it worth giving up 2.3% on average to cut the downside from roughly 12% to 5%? That is a question investors should consider for themselves.

What if My Luck Is Really Bad?

Nobody wants to invest at the top of a market, but what if you did? To examine this, we went back to the "technology bubble" that ended with a severe drop in the U.S. stock market of more than 40% from 2000 to 2002. We looked at different entry points before, during, and after the bear market, starting in 1998 and ending in 2004. In each case, we assumed the entire investment of $10 million was made at the beginning of the year in the target allocation of 70% stocks and 30% bonds. Results are shown in Exhibit 3.

An investor with unfortunate timing who invested at the market peak at the beginning of 2000 certainly hasn't done as well as the investor who started in 1998 and enjoyed two strong years of a bull market, or the investor who was smart/lucky enough to invest at the bottom in early 2003. But the investor who entered the market at the peak in 2000 isn't destitute either. The $10 million investment has doubled to $24 million by 2019, and the compound annual return has averaged 4.6%. Admittedly, this return for a 70/30 mix is low as compared to history, but it may not be as detrimental to long-term wealth as one might expect based on such an untimely entry point.

Investment plans should be designed and stress tested with severe bear markets in mind, but investors should also remind themselves of the odds — severe bear markets are unpleasant but fortunately infrequent events, and stocks trend up more often than not. Over approximately the last 50 years, returns for the S&P 500 Index have been positive in 74% of one-year periods, 79% of three-year periods, and 91% of 10-year periods.[5]

Exhibit 3: Getting Invested Around the Tech Bubble of 2000–2002

Key Takeaway: An investor who entered at the height of the tech bubble realized a lower annualized return, though it was not as pronounced as one would expect.

Invest $10 Million Immediately In	Current Portfolio Value Today ($ Mil.)	Annualized Return
1998	$34	5.8%
1999	$27	5.0%
2000	$24	4.6%
2001	$25	5.1%
2002	$27	5.8%
2003	$31	7.0%
2004	$26	6.3%

As of September 30, 2019. Annualized return starts Jan. 1 in the year mentioned in the left column and concludes September 30, 2019. Returns reflect total return. Asset allocation is 70% stocks and 30% bonds. The following indices were used to measure returns: S&P 500 (stocks), GFDatabase USA 10-year Government Bond Total Return Index in 1998 and Bloomberg Barclays U.S. Government 10 Year Term Index Total Return from 1999 on (bonds). The $10 million investment occurs at the beginning of each calendar year. Analysis does not factor in the impact of taxes, inflation, or spending. From calendar year 2000-2002, the value of the S&P 500 fell 40.1%. Looking at monthly data, the market peaked at the end of March 2000, and the trough was the end of September 2002. Measured monthly, the value of the S&P 500 fell 45.6% during this period.

Source: Barclays, Bloomberg, Global Financial Database, Standard & Poor's

The Importance of a Plan

Even though, on average, getting invested immediately has historically been the right approach, it is easier said than done, particularly since the financial crisis of 2007 to 2009. That bear market left a big wake, and investors still remember the havoc it wreaked on their portfolios. If dollar-cost averaging helps someone get invested in his or her target allocation over a short period of time (ideally three to six months, but not to exceed a year), then it is a useful tool in an investor's tool kit. Dollar-cost averaging is a bit like an insurance policy — on average, it has historically cost you return, but occasionally it pays off nicely.

For those investors who are extremely hesitant to invest new money in their target asset allocation today or within the next three to six months, this may be a sign that their target is too aggressive. Perhaps reducing the target allocation to stocks by 10% to 20% might provide the necessary courage to transition more quickly.

Although we certainly try to make this exercise more of a science and less of an art, in part by studying history and trying to understand its lessons, we recognize the process of getting invested is deeply infused with emotion, and the best plan is often customized and crafted one-on-one. Regardless of the exact details of your specific plan, we suggest you put the plan in writing and keep it simple. The more complicated it is, the tougher it is to execute and see through. And once you have made the decision to implement your plan, avoid the temptation to constantly reevaluate each of your entry points with the swings of the market. Hopefully you can make the decision once to implement your plan and then move on to other things. And finally, remember that getting invested is always emotionally difficult — for everyone.

Special Case: Entering the Market for Former Private Business Owners

Getting invested can be particularly difficult emotionally for those whose liquid wealth is the result of selling a business they recently owned. This is because the way business owners view and experience their wealth changes dramatically after the business is sold and the proceeds are invested in the financial markets.

Many times, when business owners are running a business, they have a perception of total control — having started, owned, and managed it. The business owner who wants to make more money would work harder and smarter. And the value of the business wouldn't seem to change much from day to day or month to month.

The stock market is a completely different animal. In the short run, it can fluctuate wildly, be divorced from any fundamental value, and to top it off, investors in the stock market get to watch their net worth change by the second (which takes some getting used to). So even though former business owners have sold their very concentrated, illiquid holding and diversified their risk considerably, it will often *feel* like they have gone from a low-risk investment to a high-risk one, particularly early on in this process. This highlights the need for a thoughtful approach to both getting in the market and constructing the most appropriate target asset allocation.

Is This Time Different?

It is dangerous to assume this time is different, but it could be. Recognizing that "now" always feels like a tricky time to invest, now really does feel like a tricky time. Stock markets have moved up considerably this year, but the global economy is experiencing some soft patches, particularly in Europe, where German manufacturing weakness is causing headwinds. Meanwhile, trade disputes between the U.S. and China (and now a possible escalation between the U.S and Europe) have caused hesitancy on the part of companies to ratchet up capital spending. Political challenges in many countries, including the U.S. (impeachment inquiry) and the U.K. (Brexit), further cloud the outlook.

While the current environment has its challenges, we continue to believe the long-term trend for the market will be up. Global central banks are largely in easing mode, and interest rates remain low relative to historical levels, supporting consumers and businesses. Labor markets and consumer spending remain strong, providing some level of footing for economic growth. It is important to note that stocks are more likely to suffer periods of sustained sell-offs going into and during recessions (see our *Quarterly Investment Perspective*, "R&R"). We continue to believe that while we are in the later stages of the economic cycle, a recession is not imminent.

As always, we continue to actively manage the risk in our clients' portfolios. After recent asset allocation moves, our positioning is now slightly more defensive as compared to benchmarks. For clients investing new money today, we recommend moving to their target asset allocations over a relatively short time period, either immediately or over the next three to six months.

Endnotes

(1) For simplicity, our study looked at U.S. stocks only. Other studies that have examined non-U.S. or global markets have shown similar tradeoffs. Our study covers the time period from January 1, 1967 to September 30, 2019.

(2) Although not shown in the displays, we also examined staging into the markets over periods extending beyond 12 months, looking at dollar-cost averaging over 24 and 36 months. As you might guess, this becomes an even more expensive insurance policy, cutting returns more on average by holding lower-returning cash longer. The evidence suggests that delaying reaching your target allocation for this long does not provide a good tradeoff for investors.

(3) The bars capture 90% of the historical outcomes (from the top 5% down to the bottom 95%) and are meant to show a wide range of historical returns, but by definition do not include the extremes. During this period, the maximum and minimum (actual best case and worst case) values were:

	Maximum (%)	Minimum (%)
Immediately	53.4	(44.8)
3 Months	50.5	(45.6)
6 Months	43.6	(44.2)
12 Months	29.3	(38.0)

Looking at the extremes paints a different picture but still has us arrive at the same conclusion. Dollar-cost averaging didn't add much protection when examining the minimum values but certainly limited upside as shown by the maximum values that decline significantly as the time period increases. Looking at the extreme outcomes would suggest moving to the target asset allocation immediately. We caution, however, about designing investment planning strategies based on focusing too much on extreme outcomes.

(4) The 30% in bonds is assumed to be invested immediately in all scenarios, and the stock investments are staged in as labeled. This is because stocks, not bonds, are the big driver of risk in the overall portfolio (in the short term, the downside risk of bonds is much lower than the downside risk of stocks). Staging into bonds lowers returns while having very little impact on overall portfolio risk.

To keep this paper brief, we simply looked at target allocations of 100% U.S. stocks and 70% U.S. stocks/30% bonds, but many more combinations are possible. Our recommended client asset allocations are typically much more diversified and would include non-US stocks, mid- and small-capitalization stocks, credit instruments (corporate bonds and mortgage bonds, for example), and alternative investments, including hedge funds and private equity.

During this period, the maximum and minimum (actual best case and worst case) values were (for 70% stocks / 30% bonds):

	Maximum (%)	Minimum (%)
Immediately	48.1	(31.8)
3 Months	46.6	(32.6)
6 Months	40.9	(31.3)
12 Months	30.2	(24.1)

(5) As measured by rolling monthly returns for the S&P 500 from 1967 through the end of September 2019. Returns have been positive in 100% of 20-year periods, but this of course is no guarantee that going forward this will be true.

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