AN ARGUMENT AGAINST STOCK-PICKING AND MARKET-TIMING: AN EMPIRICAL APPROACH

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ABSTRACT

This paper's objective is to demystify the world of investing, first by showing and exposing the results the greatest money managers in the Wall Street have obtained over the last years compared to the performance of their benchmark indexes. Index investing represents a passive investment strategy of holding hundreds of stocks instead of the active management approach used by these experts. After exposing said results, a theoretical framework will be presented that explains why money managers have such a difficult time outperforming their benchmark indexes. Later on, a back-test experiment will be presented and thoroughly explained showing five different hypothetical investment scenarios over several 20-year periods with the attempt to quantify the potential benefit of perfectly timing the market and compare it to the cost of waiting for a better time to invest. The results find shows that the cost of waiting is much greater that the potential benefit of perfectly timing the market and the best alternative would be to invest available cash immediately regardless of market or economic outlook.

Keywords: Market-Timing, Market Efficiency Hypothesis, Portfolio Management, Investment.

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