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Stu's View

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Coming to grips with your acrophobia

Truth be told, I'm deathly afraid of heights. I have always suffered from acrophobia, or what is known as having a fear of heights. You'll never catch me walking on top of the CN Tower, or peering over the edge atop the 40th floor at Royal Bank Plaza. The fourth step on my garage ladder is about as far as I ever go. However, I am not afraid of heights as it pertains to the markets.

Every so often, the question about whether or not to invest when the market hits all-time highs takes centerstage. People usually ask this question after a sustained rally and new highs. Because everyone likes to feel like they got a great deal on something they own, they tend to want to avoid buying at an all-time high thinking that the markets will likely go lower. They want to wait for a better time to buy – when the markets go lower and they can get a "deal." We call that a bit of regret aversion. But does that lead to a successful investment strategy over time?

Regular readers know that this sort of market timing generally is a loser's game. In this article we take a look at the performance of local and global indexes year to date, and consider the proposition that investing at all-time highs doesn't necessarily mean near-term losses ahead. One way to deal with said acrophobia as it relates to investing is to invest regularly (i.e. dollar-cost averaging), which can take the emotions and doubt away from the decision-making process. So hold on tight, let the flight begin. We're nearing an all-time high.

High times

Despite the growing number of COVID-19 cases in the world as we arguably live through wave two of the virus spreading, most equity markets have recently made or are near all-time highs. All-time highs are exactly what they mean. This is "uncharted territory" in the sense that prices have never been this high in the past. But unlike reaching the peak of Mt. Everest (no, not for me either), there are further all-time highs to come in the market. Remember that investment decisions are generally made based on forward-looking assumptions rather than past data or prices.

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Table 1: Global/local equity Indexes sorted by % from all-time high

Index Name	Price (Nov 24/20)	YTD %Chg	All-time High Price	All-time High Date	% from All-time High
DJ 30 Industrials Average	30,046	5.28%	30,046	24-Nov-20	0.0%
S&P 500	3,635	12.52%	3,635	24-Nov-20	0.0%
Korea KOSPI	2,602	18.38%	2,618	24-Nov-20	-0.6%
Canada S&P/TSX Composite	17,274	1.24%	17,944	20-Feb-20	-3.7%
Germany DAX (TR)	13,267	0.13%	13,789	19-Feb-20	-3.8%
ASX All Ordinaries	6,888	1.26%	7,255	20-Feb-20	-5.1%
FTSE 100	6,432	-14.72%	7,877	22-May-18	-18.3%
Hang Seng	26,670	-5.39%	33,154	26-Jan-18	-19.6%
France CAC 40	5,555	-7.08%	6,922	4-Sep-00	-19.7%
Nikkei 225	26,297	11.16%	38,916	29-Dec-89	-32.4%
EURO STOXX 50 (EUR)	3,503	-6.46%	5,464	6-Mar-00	-35.8%

Source: FactSet, RBC PH&N Investment Counsel. You cannot invest in an index. For a complete description of all indexes in this table please see the appendix. All prices are in local currencies, returns are time weighted and gross of fees, and dividends reinvested. YTD % chg indicates the percentage change from Jan. 1, 2020 to Nov. 24, 2020. All-time high price indicates the highest closing price for each index. All-time high date indicates the date corresponding to the all-time high price. % from all-time high indicates the difference between the prices at Nov. 24, 2020 and the All-time high price. Past performance is not a guarantee of future results.

Although "all-time highs" garner the attention of a certain U.S. President and most of the media, in reality, they should not be unexpected. Equity markets grow with the local and global economy over time, and during economic expansion periods they may see new all-time highs. In fact, during the last 20 years, the S&P 500 Index established a new all-time high almost 30% of the time.

In order to better understand the forward-looking returns from all-time highs, we reviewed the monthly trading data for the S&P 500 Index going back to 1930, or close to 1,100 data points. In Table 2 we show the forward one-year returns in the S&P 500 Index associated with different timing strategies, and also a measure of probability of occurrence for each strategy:

- **Dollar-cost averaging:** Dollar-cost averaging is a simple technique that entails investing a fixed amount of money in the same fund or stock at regular intervals. As the price of the investment declines, you buy more of that investment with your fixed-dollar amount. And likewise as the price increases, you buy less with your fixed dollars. This is the "set-it-and-forget-it" strategy that you don't need any market forecast for. You would have only had to make sure that you were investing regularly to achieve these results. There is zero market timing involved here.
- **Investing when the market reaches a new all-time high:** This is the "non-acrophobia portfolio" that invested money only when the market hit an all-time high. Intuitively this doesn't sound like a great value proposition but the results in Table 2 suggest otherwise. All-time highs have occurred approximately 18% of trading days over the entire 1930-

Table 2: S&P 500 Index forward one-year returns (1930-2019)

Monthly data: 1930-2019	Dollar Cost Averaging	Invest at all-time high	Invest at TTM-high	Invest at TTM-low
Average return	7.7%	6.7%	7.5%	7.5%
Median return	9.1%	8.3%	8.5%	8.4%
Prob. of occurence	100%	18%	31%	10%
Prob. of positive return	68%	72%	75%	65%
Prob. of negative return	32%	28%	25%	35%

Total number of months	1,093
Total number of all-time highs	198
Total number of TTM highs	337
Total number of TTM lows	110

Source: FactSet, RBC PH&N Investment Counsel. Monthly data for 12-month period returns from January 1930 to December 2019. S&P 500 Index description can be found in the appendix. An investment cannot be made directly into an index, all returns are calculated from month-end price for the index, using time-weighted daily returns in U.S. dollars, price returns only, gross of fees, trading costs and fees. Past performance is not a guarantee of future results. Definitions used in the table: TTM = Trailing Twelve Months (gross returns over the preceding 12-month period). TTM-highs = the index level high over the preceding 12-month period. Forward 12M returns = gross returns over the proceeding 12-month period. TTM-lows = the index level low over the preceding 12-month period. Probability of occurrence corresponds to the number of instances for each strategy divided by the number of months in the study period. Probability of positive return = the number of positive forward returns (returns > 0.0%) divided by the total number of instances in the study period. Probability of negative return = the number of negative forward returns (returns < 0.0%) divided by the total number of instances in the study period.

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2020 time period, but we have seen more frequent all-time highs in the S&P 500 over the last two decades.

- **Investing when the market is at a 12-month high:** This is another version of the non-acrophobia portfolio that isn't afraid of new highs in the market over the preceding 12-month period. Here you only invested money when the market hits a new 12-month high. The probability of occurrence is quite high when compared to all-time highs.
- **Investing when the market is at a 12-month low:** If you could only know when the low point would be in advance. However, we decided to run the numbers anyway to see how this might look with 20/20 hindsight. It turns out that investment returns from a 12-month low in the market did not actually result in any significant excess return when compared to either of these strategies.

There are a number of interesting highlights to note from Table 2.

- Forward returns using a dollar-cost averaging strategy were superior to the timing strategies. The median forward one-year return was not only higher than the strategies, but there was no timing involved whatsoever. It carries the highest probability of occurrence at 100% provided you were investing regularly, irrespective of what the market price was at the time of purchase.
- Despite the acrophobia with all-time highs, the forward one-year returns from all-time highs were fairly attractive, and the odds of a positive return one-year forward were quite high at 72%. While all-time highs occurred in only 18% of trading months observed in the study, they have increased in frequency in more recent years. These past results might suggest that perhaps we don't need to be afraid of heights after all.
- When the market had established a new one-year high, it didn't pay to wait and not invest either. This happened 31% of the time, and the forward one-year returns were attractive, along with a high probability of positive returns at 75% of the time.
- Finally, even if you had perfect hindsight (we never do!) and invested at the low for any given 12-month period in the market, you were really no better off than the dollar-cost averaging strategy, which takes no market timing consideration at all.

To conclude, despite the recent all-time highs, we are not suggesting that you should change your investment approach or strategic asset mix. The data suggests that new all-time highs shouldn't be feared, and certainly shouldn't be a signal for investors to not invest, or change course. Dollar-cost averaging is your best option to ensure that you are not waiting for any market pullback to invest, and conversely not waiting for any all-time high to take profits or sell. And just because the market hits a new all-time high, it doesn't signal any imminent downturn to come. Do not fall into the trap of waiting for the "better entry point," which may not show up. By waiting, and timing the market, you could likely be foregoing subsequent gains.

Be well,
Stu

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S&P 500 Index: The S&P 500 Index includes 500 companies across many sectors of the U.S. economy. The index is weighted by market capitalization so bigger companies make up a larger proportion of the index than smaller companies. The index is designed to measure performance of the broad US economy through changes in the aggregate market value of the largest US companies.

DJ Industrial Average: The Dow Jones Industrial Average is a price weighted index comprised of 30 of the largest and most widely held public companies in the United States. The daily high and low prices for DJII are theoretical.

Canada S&P/TSX Composite: Comprises the majority of market capitalization for Canadian-based, Toronto Stock Exchange listed companies. It is a benchmark used to measure the price performance of the broad, Canadian, senior equity market. It was formerly known as the TSE 300 Composite Index.

Euro STOXX 50: The STOXX Indices are published by STOXX Limited, owned by Deutsche BorseAG and SIX Group AG. The series of market indexes that are representative of the European and global markets. These indexes cover a wide range of market segments including the broad market, blue chips, individual sectors and global indexes.

FTSE 100: This index comprises the 100 most highly capitalised blue chip companies, representing approximately 81% of the UK market. It is used extensively as a basis for investment products, such as derivatives and exchange-traded funds.

France CAC 40: The CAC 40 index is the main benchmark for Euronext Paris. Tracking a sample of Blue Chip stocks, its performance is closely correlated to that of the market. The index contains 40 stocks selected among the top 100 market capitalisation and the most active stocks listed on Euronext Paris, and is the underlying asset for options and futures contracts. The base is 1,000 at December 31, 1987.

Germany DAX (TR): The Dax measures the performance of the Prime Standard's 30 largest German companies in terms of order book volume and market capitalization. The index is based on prices generated in the electronic trading system Xetra®. Its calculation starts at 9.00 a.m. and ends with the prices from the Xetra closing auction at 5.30 p.m.

ASX All Ordinaries: The index is made up of the weighted share prices of about 500 of the largest Australian companies. Established by ASX at 500 points in January 1980, it is a measure of the overall performance of the Australian sharemarket. The companies are weighted according to their size in terms of market capitalization (total market value of a company's shares).

Hang Seng Index: The Hang Seng Index (HSI) comprises stocks with primary listings on the Hong Kong Stock Exchange. To be eligible stocks must be amongst those constituting the top 90% by market value and turnover. Selection is based on market value, turnover and sub-sector representation.

Japan Nikkei 225: The Average has been calculated since September 7, 1950 using the Dow Jones method. The 225 components are among the most actively traded issues on the TSE first section. The Average represents the performance of first section stocks and the general market. Components have been rebalanced from time to time to assure liquidity and representation of Japan's industrial structure.

KOSPI Composite Index: The Korea Composite Stock Price Index (KOSPI) is an index of all companies traded on the Korea Stock Exchange. The index is a market capitalization based index introduced in 1983. The base value of 100 was set to January 4, 1980. Its all-time low is 31.96 points, reached on June 16, 1998. The KOSPI hit all-time high on May 11, 2006.

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