MARKET TIMING

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A WEALTH OF COMMON SENSE
JUNE 15, 2023

Short-term interest rates remain high as the economy's performance is stronger than expected.

We're looking at 5% yields across the board for short-term government bonds.

Short-term yields have been on the floor for so long that 5% interest rates are bound to grab the attention of investors.

TREASURY YIELDS

NAME	COUPON	PRICE	YIELD
GB3:GOV **3 Month**	0.00	5.05	5.20%
GB6:GOV **6 Month**	0.00	5.09	5.31%
GB12:GOV **12 Month**	0.00	4.92	5.19%
GT2:GOV **2 Year**	4.25	99.27	4.64%
GT5:GOV **5 Year**	3.63	98.68	3.92%
GT10:GOV **10 Year**	3.38	97.11	3.73%
GT30:GOV **30 Year**	3.63	96.13	3.84%

Past performance is not indicative of future results. Source: Bloomberg.

For a few years, rates were so low many investors were being forced out on the risk curve. There were plenty of balanced investors who preferred a 60/40 portfolio but opted for a 70/30 or 80/20 mix because bond yields were so pitiful.

The good news about 5% bond yields is that more conservative investors no longer have to stretch for yield.

Your expected returns are obviously much better when yields are at 5% than when they are at 1% or less.

Your asset allocation can change for any number of reasons.

Your financial circumstances or goals could change. Your willingness, need, or ability to take risk could change. The markets could change.

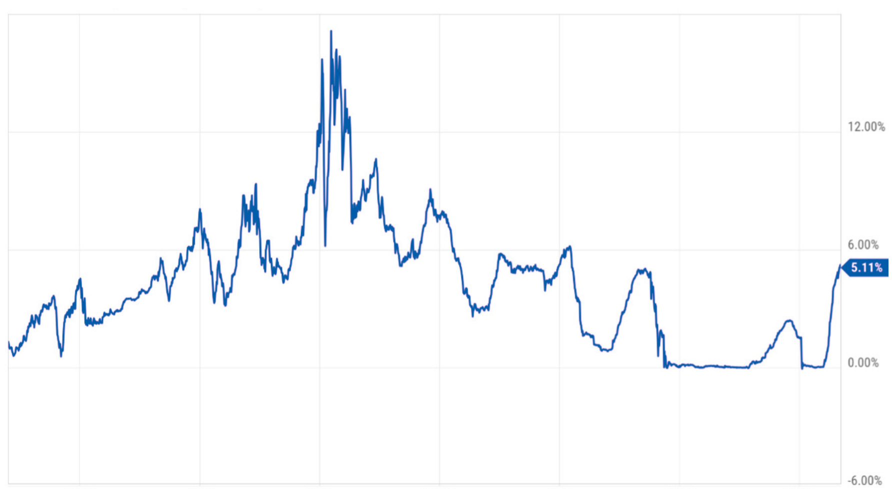
But there is an important distinction between an asset allocation decision based on risk vs. reward trade-offs and market timing.

There are a few problems with making a huge shift in your portfolio, and one of them is that interest rates can be fickle.

They can go up quickly, but also drop in a hurry.

Short-term bond yields could stay elevated for a time if the economy and inflation remain strong and the Fed keeps rates higher for longer.

3-MONTH TREASURY BILL RATE



Past performance is not indicative of future results. As of 6/15/23. Source: YCharts.

But what happens if/when short-term rates go back down? If the Fed keeps raising rates, eventually that's going to slow things down, if it hasn't already.

When inflation slows and the economy weakens, the Fed is going to cut rates – in fact they already paused, ending the streak of 10 consecutive rate hikes. Unfortunately, T-Bill yields won't be 5% if inflation is 3%. Today's 5% yields aren't going to last forever.

No one knows what's going to happen in the short term when it comes to interest rates or the stock market (not even the Fed).

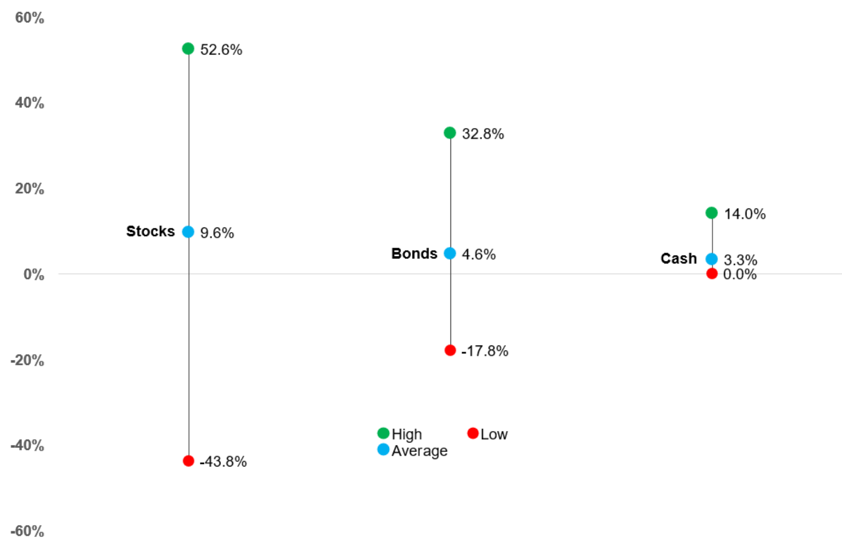
In the short run, cash may offer stability. At the moment, it also offers pretty good nominal yields. However, in the long run, you'll barely keep up with inflation.

In the short-run, stocks can rip your heart out. No one knows if we are in a new secular bull market or if we are in for more carnage. But, in the long run, the stock market remains the best bet for beating inflation and compounding your wealth.

Moving in and out of cash may sound appealing right now but it's harder than it sounds. Market timing requires being right twice.

Getting out is easy. Getting back in is not.

STOCKS, BONDS, AND CASH: ANNUAL RETURNS 1928-2022



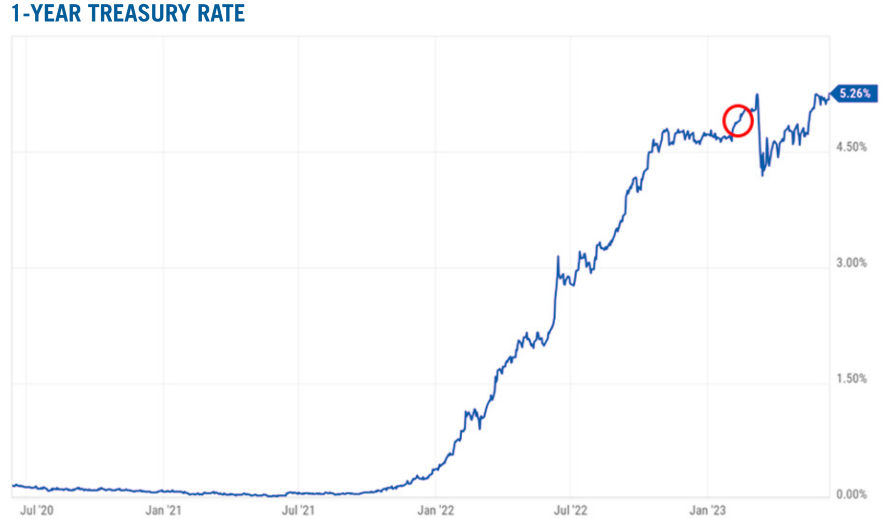
Past performance is not indicative of future results. S&P 500, 10-Year Treasuries, and 3-Month T-Bills. Source: NYU.

The best case would be you move some or all of your portfolio into cash, the stock market drops, you clip your 5% and miss out on some losses, then shift back to stocks when yields fall.

The worst case is you move some or all of your portfolio into cash, yields fall, the stock market rips, you miss out on the gains, and now you're stuck in an asset class with lower expected returns.

In February 2023, the general consensus was why take stock market risk when you can yield 5% risk free? TINA (there is no alternative) was replaced by TARA (there are reasonable alternatives) in terms of risk and reward.

1-YEAR TREASURY RATE



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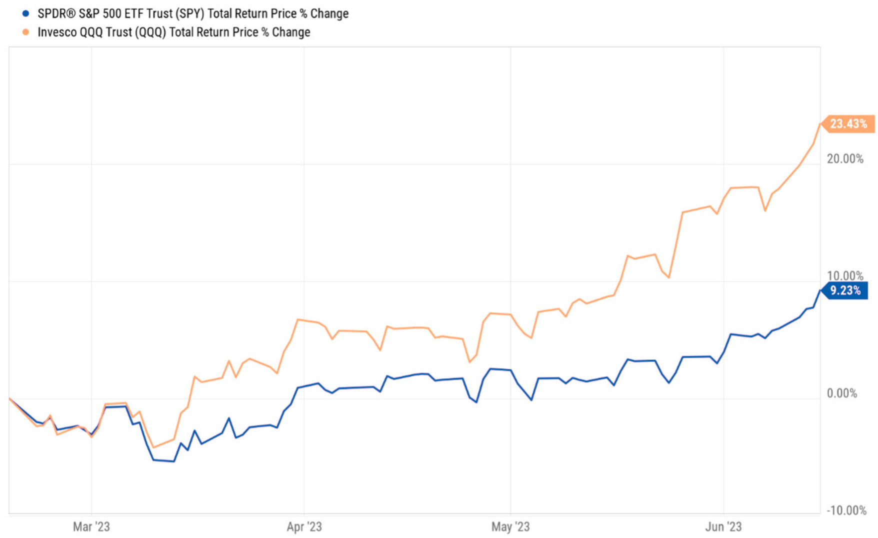
For investors with short-term spending needs, this is a welcome development. You can finally earn a decent yield on high-quality short-term U.S. government bonds. Those rates are now as high as they've been in the post-Great Financial Crisis era.

But for investors with time horizons in decades, de-risking at the wrong time can burn you.

The one-year U.S. Treasury yield crossed 5% on February 17th of this year for the first time since 2007. Since that point, the S&P 500® Index is up 9% while the Nasdaq 100 has rallied 23%.



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If you would have tried to time the market by moving your portfolio from stocks to cash, you would have missed out on a huge rally. And then you would still have to figure out what to do with that cash. Wait for the market to fall again? Redeploy now to avoid missing out on further gains?

Market timing puts you in a tough spot.

The point of this piece is not to talk anyone into or out of any asset class.

Cash has a place in a portfolio for short-term liquidity needs and stability.

Bonds have a place in a portfolio to provide income and protection against deflation and disinflation.

Stocks have a place in a portfolio to provide the potential for higher expected returns and protection against the long-term impacts of inflation.

It's difficult to constantly shift your asset allocation into and out of these asset classes without causing some harm to your investment plan over the long run.

Asset allocation is for patient people.

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