Is It Worse to Miss the Best or Best to Miss the Worst?

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When I entered the business of investments in 1982, conventional thinking had been to stay invested all of the time so the “best” days in the markets were not missed. Mutual funds have continued to tout this concept by saying it’s the time “in” the market, not time-“ing” the market that works better. They verify this adage with results from missing out on the “best” 10, 20, days or more days of investment returns.

However, they are ignoring an important idea. What if you miss out on the 10, 20, or more “worst” days?

This question was recently answered by a study titled “Black Swans and Market Timing: How Not To Generate Alpha”, by Javier Estrada, International Graduate School of Management, Barcelona, Spain. The data presented covered the Dow Jones Industrial Average for the timeframe from January 1, 1900 through December 31, 2006, 107 years totaling 29,190 trading days. The following was found:

Starting with $100 at the beginning of 1900, it grew to $25,746 by the end of 2006, which resulted in a mean annual compound return of 5.3%. This resulted from being in the market all the time.

If you missed the 10 “best” days, your wealth was reduced to only $9,008, which was a mean annual compound return of 4.3%.

If you missed the 20 “best” days, your wealth was reduced to only $4,313, which shows a mean annual compound return of 3.6%.

If you missed the 100 “best” days, your wealth was reduced to only $83, which was less than you started with and a mean annual compound return of - 0.2%.

So, now let’s look at the results of missing the **“worst”** days.

If you avoided the 10 “worst” days, your wealth grew to $78,781, which shows a mean annual compound return of 6.4%.

If you avoided the 20 “worst” days, your wealth grew even more to $162,588, which is a mean annual compound return of 7.2%.

If you avoided the 100 “worst” days, your wealth grew to an astonishing $11,197,734. That represents a mean annual compound return of 11.5%. No, that’s not a “typo”! It is really more than $11 million.

It is abundantly clear that successful attempts to miss the worst down days could not only reduce risk but gain much more than catching the biggest up days. Perhaps more importantly, there is no evidence that avoiding the “worst” days will result in missing out on the “best” days. Additionally, most of the “best” and “worst” days occur in the midst of major trends that are easily identifiable.

The conclusion is that it takes no particular skill to just stay in the market and be happy with participating in the “best” days. However, history shows that the potential reward of significant outperformance by avoiding the “worst” days is worth mastering the necessary skills to achieve that goal.