

[Login](#)
[Search](#)
[Homepage](#)

Between the Issues

[Your Practice](#)
[Technical Articles](#)
[Essays & Letters](#)
[Books](#)

[Links & Resources](#)



Between the Issues

Missing the Ten Best

by Paul J. Gire, CFP®

Paul J. Gire, CFP®, president of Strategic Advisory Services Inc., in Orinda, California, has been a financial planner for over 22 years. He specializes in retirement planning, investment, and portfolio management. He is a member of the East Bay Chapter of the Financial Planning Association.

Abstract

For years Wall Street and the mutual fund industry have advanced the concept that investors should buy and hold. A common piece of evidence to support this recommendation is various versions of “Don’t Miss the Ten Best,” which show that missing just a small percentage of the market’s best days dramatically reduces investor returns.

A closer look reveals that all may not be as it first appears, that this may be a misleading characterization of market history. If so, “Don’t Miss the Ten Best” could be construed as an ethical violation of both the CFP Board’s Code of Ethics and Professional Responsibility (Code of Ethics), and the Securities and Exchange Commission’s Rule 206(4)-1 under the Investment Advisers Act of 1940.

In light of these findings, advisors may want to consider either refraining from future reference to such studies, or add an additional disclaimer.

We’re all familiar with David Letterman’s famous top ten lists. Wall Street coined its own version long before Letterman stood in front of a microphone. This one’s called “Missing the Ten Best”—Wall Street’s rationale for why investors should buy and hold. We’ve all heard this one: how missing the stock market’s ten best days causes one to miss much of the market’s gains.

This assertion has been repeated so often in various forms that it’s become unquestioned. Like the air we breathe, this orthodoxy is unconsciously accepted and taken for granted. Think about it. Have you ever read an article that critically examines this claim? Have you read an article that disputes this belief? I’ve read them in newsletters, but I’ve not seen any in the professional journals. Isn’t it odd that financial advisors analyze investments through an increasingly complex array of factors (market cap, styles, growth rates, sectors, earnings yields, balance sheets, company management, and so on) but never critically review this viewpoint?

Advisors and analysts who should know better repeat this mantra, revealing that either they don’t know better, or they do know better and they’re perpetuating a myth on the investing public. Just recently the president of a large San Francisco money manager, writing in the company’s quarterly newsletter, cited statistics provided by Charles Schwab and Company showing the “importance of being invested...just a few trading days each year...for the ten-year period from 1994 though 2003, only 10 days accounted for almost half of the gain during the period. That’s 10 days out of about 2,600.” Wow. You’re kidding. Missing just ten days out of 2,600 cut my return in half? That’s amazing. How could I not keep my clients fully invested?

A Closer Look



One day, while perusing *The Wall Street Journal's* Web site, I ran across a table listing the top one-day gains and losses for the Dow Jones Industrial Average (Dow), and noticed an interesting phenomenon. The worst days seemed to be in close proximity to the best days. Hmm...that woke up my little gray-matter cells and I decided to take a closer look. First off, of the top 20 largest percentage gainers, 16 of them occurred in the aftermath of the 1929 crash, during the early 1930s. Right away I learn that, as a buy-and-hold investor, in order to be sure to experience the joys related to the majority of largest percentage gainers, I've first got to go through the 1929 crash. I'm beginning to wonder if this is the best course of action. (See Table 1.)

Largest % Gains					Largest % Losses				
Rank	Date	Close	Net Chg	% Chg	Rank	Date	Close	Net Chg	% Chg
1	03/15/33	62.10	8.26	15.34	1	12/12/14	54.00	-17.42	-24.39*
2	10/06/31	99.34	12.86	14.87	2	10/19/87	1738.74	-506.00	-22.61
3	10/30/29	258.47	28.4	12.34	3	10/28/29	280.64	-38.33	-12.82
4	09/21/32	75.16	7.67	11.36	4	10/29/29	230.07	-30.57	-11.73
5	10/21/87	2027.85	106.84	10.15	5	11/06/29	232.13	-25.55	-9.92
6	08/03/32	58.22	5.06	9.52	6	12/18/1899	58.27	-5.57	-8.72
7	02/11/32	78.60	6.80	9.47	7	08/12/32	63.11	-5.79	-8.40
8	11/14/29	217.26	18.59	9.36	8	03/14/07	76.23	-6.69	-8.29
9	12/18/31	80.69	6.90	9.35	9	10/26/87	1793.93	-156.63	-8.04
10	02/13/32	85.62	7.22	9.19	10	07/21/33	88.71	-7.55	-7.84
11	05/06/32	59.01	4.91	9.06	11	10/18/37	125.73	-10.57	-7.75
12	04/19/33	68.31	5.66	9.03	12	02/01/17	88.52	-6.91	-7.24
13	10/08/31	105.79	8.47	8.70	13	10/27/97	7161.15	-554.26	-7.18
14	06/10/32	48.94	3.62	7.99	14	10/05/32	66.07	-5.09	-7.15
15	09/05/39	148.12	10.03	7.26	15	09/17/01	8920.7	-684.61	-7.13
16	06/03/31	130.37	8.67	7.12	16	09/24/31	107.79	-8.20	-7.07
17	01/06/32	76.31	5.07	7.12	17	07/20/33	96.26	-7.32	-7.07
18	10/14/32	63.84	4.08	6.85	18	07/30/14	71.42	-5.30	-6.91
19	03/15/07	81.33	5.10	6.69	19	10/13/89	2569.26	-190.58	-6.91
20	06/20/31	138.96	8.65	6.64	20	01/08/88	1911.31	-140.58	-6.85

*12/12/14 was the first trading day after a market shut down due to World War I. The percent change for that day is based on the previous close of 71.42 on 7/30/14.

Detailed Findings

I then compared the largest percentage gain (15.35 percent on March 15, 1933) with the list of the largest percentage losers. I found that 2 of the top 20 biggest percentage losers occurred four months later—July 20, 1933 (−7.07 percent) and July 21, 1933 (−7.84 percent). Since this confirmed my initial quick take on large gains and losses occurring in close proximity, I reviewed the 19 other occurrences:

- In the majority of cases, large percentage gainers were no more than 90 trading days away from a large percentage loser, sometimes before and sometimes after.
- One exception was the large one-day gain on September 5, 1935, in which there was no large losing day associated with it.
- In 50 percent of the cases, gainers and losers were separated by no more than 12 trading days.
- When looking at Nasdaq's 20 largest gainers and losers (not shown) of the 20 largest one-day gains, all but two of them occurred during the bear market of 2000–02, when the Nasdaq crashed 78 percent.

These observations make it hard to believe that investment success rested upon being fully invested in order to catch these winning days. Rather, especially in the case of the Nasdaq crash of 2000, it suggests that it was more important to miss the worst bear market since the 1929 crash—which brings us to the other side of the coin: All of the “Don't Miss the Ten Best” articles fail to mention what would happen to my portfolio if I missed the ten *worst* days. We know that, given the mathematics of compounding (where it takes a 100 percent gain to make up for a 50 percent loss) and Monte Carlo retirement analysis (which shows that low volatility portfolios often last longer than those tuned for high returns), it's more important to avoid large losses than it is to pursue large gains. What does this illustration look like if, rather than missing the ten best days, we miss the ten worst?

I decided to run another study. I was concerned that the previous data, dominated as it was by the singular event of the 1929 crash, may have skewed my findings. So I tried to achieve a more balanced view by examining one of the most bullish periods in Dow history, from 1984 to 1998. In addition, I examined the impact from missing not just the 10 best and worst days—I also examined the 20, 30, and 40 best and worst days. Here's what I found:

- The buy-and-hold return for this 15-year period was 17.89 percent—one of the most bullish periods in market history.

S&P 500
17.89%
(1/84 to 12/98)

- As expected, missing the best days lowered returns, and missing just 40 of the best days over this 15-year period cut returns nearly in half. (See Table 2.)

# Of Trading Days Missed	Best
10 days	14.24%
20 days	11.99%
30 days	10.01%
40 days	8.23%

- Similarly, missing the worst days has the expected result of increasing returns substantially. As shown in Table 3, no surprises except perhaps the magnitude of improvement (77 percent) for missing the 40 worst days.

# Of Trading Days Missed	Best	Worst
10 days	14.24%	24.17%
20 days	11.99%	27.04%
30 days	10.01%	29.45%
40 days	8.23%	31.66%

- Now we come to what may be the heart of the matter. What if we were to miss both the best days and the worst days?
- The payoff for missing both is a remarkably consistent result. Whereas missing just the best or worst had a magnified impact as the number of days increased, missing both produces a consistent return of approximately 20 percent, as shown in Table 4.

# Of Trading Days Missed	Best	Worst	Both
10 days	14.24%	24.17%	20.31%
20 days	11.99%	27.04%	20.68%
30 days	10.01%	29.45%	20.80%
40 days	8.23%	31.66%	20.87%

- Not only does missing both result in superior returns—imagine the knock-off benefits from lower volatility, especially on client psychology. As many advisors have learned since the 2000–02 bear market, it’s one thing to encourage clients to stay the course when markets are trending steadily higher, quite another when bear markets rapidly erode the gains from years of careful saving and investing. In 30 months the 2000–02 bear market erased half of the market gains of the previous 26 years—since 1974.

That’s Nice...So What?

Is it possible to devise a strategy to take advantage of these trends? My findings suggest that, given the close proximity of best and worst days, it may be unrealistic to devise a strategy that can capture one (best days) and avoid the other (worst days). But the closeness of the best and worst days, combined with the fact that they occur during periods of heightened market volatility, might allow for the possibility of devising a strategy that avoids both.

Knowledge Quest

It's beyond the scope of this article to devise a viable strategy. My purpose here is merely to suggest that a comprehensive study might yield a useful indicator. Critics will argue that this is market timing and that market timing doesn't work.

Granted, there are a multitude of studies that draw the conclusion that no one can consistently time the market (you know—like “Don't Miss the Ten Best”). But just because a thing hasn't been done is no proof that it can't be done. Clearly, successful market timing is not easily accomplished. But then, human flight, landing on the moon, and mapping the human genome were similarly difficult tasks. But that didn't stop mankind from achieving them. A quest to avoid both the best and worst days together launches us on the path toward greater knowledge, rather than deceiving ourselves that a misleading characterization of market history will help our clients attain their investment objectives.

A Question of Ethics?

In an era when yesterday's common practices are judged harshly by today's post-bubble morality, one should be careful repeating the “Don't Miss the Ten Best” orthodoxy. To the extent that it misleads investors by painting a biased view of the market's best and worst days, “Don't Miss the Ten Best” could be construed as an ethical violation of both the CFP Board's Code of Ethics and Professional Responsibility (Code of Ethics), and the SEC's Rule 206(4)-1 under the Investment Advisers Act of 1940.

Disclosure

January was the deadline for advisors to comply with the SEC's new Rule 204A-1, which requires registered investment advisers to implement a Code of Ethics. We all have to follow our own moral and ethical compass. But I'd suggest that if you've referenced one of these “Don't Miss the Ten Best” studies in the past, this might be an ideal time to purge this potentially misleading credo from your practice in order to comply with the spirit of the Code of Ethics. Or at a minimum, if you intend to continue using these “Don't Miss the Ten Best” studies, you should consider adding the following disclosure:

Following a buy-and-hold strategy, while allowing you to capture the ten best days, will also cause you to also experience the ten worst days. Psychologists, using new brain scanning technologies to map how the brain works, have learned that an investor's perception of gain and loss is not linear. Multiple substantiating studies suggest that the pain associated with a \$1 loss is twice that associated with the pleasure of a \$1 gain. Furthermore, since the worst days proceed the best days roughly half the time, probabilities suggest that, on these occasions, the pain associated with the worst days will cause you to abandon your long-term investment plan before you have a chance to experience the best days. Given the dynamics of human behavior, it's unlikely you will actually manage to experience the gains suggested by this study.

[Contact Us](#)

[Site Map](#)

Copyright ● [FPA Privacy Statement](#) ● [CFP Board Disclosure Statement](#) ● [FPA Disclosure Statement](#)