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EQUITIES, EVEN WHEN AT NEW ALL-TIME HIGHS, HAVE HISTORICALLY OFFERED LONG-TERM OPPORTUNITY FOR INVESTORS

July 2016

WEALTH INSIGHTS

BUYING AT RECORD HIGHS

The past year has been anything but a smooth ride, with two separate pullbacks of more than 10%; yet the broad stock market, as measured by the S&P 500 Index, has once again reached new record highs. Daunting challenges emerged over the year, including plummeting oil prices, international economic worries (China and Europe), and prospects of Federal Reserve (Fed) rate hikes. However, slow but steady progress for the U.S. economy, a more benign Fed, market-friendly policy from overseas central banks, and oil price stability have allowed the market to climb the wall of worry and reach new heights. Although there will no doubt be plenty of uncertainty for investors to focus on during the year ahead, the past 12 months have helped to cement our findings from just over a year ago that equities, even when at new all-time highs, have historically offered long-term opportunity for investors.

RECORD HIGHS COME IN BUNCHES

"Buy low, sell high" is one of the most recognizable stock market sayings. Investing when markets are at all-time highs would seem to fly directly in the face of this saying, leading many investors to believe that investing at all-time highs is a sure way to lose money. But is this really the case?

Buying at an all-time high, especially several years into a bull market, can be unnerving. But looking at the odds that any given all-time high is followed by another all-time high within a certain time period can be reassuring. Analysis of the S&P 500 Index indicates that from the date of any given all-time high, the index has historically hit another all-time high within one month 91% of the time. Extending this time frame to three months increases those odds to over 97%, and extending to one year the odds approach 99%. Based on those odds, you have a very good chance of seeing another all-time high pretty soon after you buy on one [Figure 1].

1 ODDS HEAVILY FAVOR AN ALL-TIME HIGH WILL SOON BE FOLLOWED BY ANOTHER ONE

	1 Month	3 Months	6 Months	1 Year
If you invest at an all-time high, what is the percent chance you'll hit another within…	91%	97%	98%	99%

Source: LPL Research, Bloomberg, S&P 500 Index 07/11/16

Data from 1928–2016, numbers rounded.

Past performance is historical and is no guarantee of future results. Indexes are unmanaged and cannot be invested into directly.

These numbers do not represent performance, but instead focus on the direction of index movement. The S&P 500 was used because it is the most broadly diversified index available for the time period, which includes the Great Depression. Though the S&P 500 officially debuted in 1957, S&P has linked returns from their older 90 and 233 stock composites to create a record going back to 1928.

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DO NOT BE SCARED BY ALL-TIME HIGHS

While these numbers are reassuring, they only tell a small part of the story. Hitting another all-time high after a short period of time is great, but if those gains evaporate before a sale takes place, they really don't matter. Are those gains sustained so they can be captured by investors over a longer-term investment horizon? The answer, historically, has been yes. Figure 2 compares the average gain seen when investing at all-time highs with the average gain investing on days where markets are not at all-time highs.

If you are going to pick a day to invest over a shorter six-month or one-year time frame, you may actually do slightly better waiting for a new all-time high to make that investment. Sounds counterintuitive, but that has been the case over time. Figure 2 shows that if you bought at an all-time high, on average, the S&P 500 was 0.5% higher after one month. After three months the average gain was better, at 1.8%, and after one year, the average gain was 7.9%. Those returns are slightly better than the average day over the entire time horizon we studied, back to 1928. Longer time horizons tend to favor investing when markets are not at all-time highs, though the numbers still show strong returns are possible even when investing at all-time highs. It is human nature to be nervous at such times, but the numbers support investment.

2 STOCKS HAVE PERFORMED WELL EVEN WITH AN ALL-TIME HIGH AS AN ENTRY POINT

	Average Cumulative Gain Investing At:		Probability of a Positive Return When Investing At:	
Investment Horizon	All-Time High	Not an All-Time High	All-Time High	Not an All-Time High
1 Month	0.5%	0.6%	58%	59%
3 Months	1.8%	1.8%	67%	62%
6 Months	3.9%	3.6%	73%	65%
1 Year	7.9%	7.5%	69%	68%
3 Years	20.1%	23.3%	77%	76%
5 Years	35.4%	42.5%	71%	78%
10 Years	75.6%	105.1%	76%	88%

Source: LPL Research, Bloomberg, S&P 500 Index 07/11/16

Data from 1928–2016.

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PUTTING THE WORST CASE SCENARIO IN PERSPECTIVE

The preceding analysis focuses on average returns from every daily all-time high since 1928, but what happened if an investor had the misfortune of buying at the absolute peak before a significant downturn? Figure 3 illustrates how long it took the S&P 500 to get back to its previous high, following the five worst sell-offs in the history of the index (and its predecessor index) back to the Great Depression. As one would expect, the results were poor over a short time horizon, but manageable for those with longer time horizons.

There is no sugar coating the 25-year wait during and following the Great Depression if an investor bought at the peak on September 16, 1929. That result is an outlier, however. Buying at the top ahead of the 2008 financial crisis took 5.5 years for stocks to regain the prior peak. Every stock market correction is painful, but a couple of key takeaways may soften the blow:

- Most investors' time horizons are longer than five years; therefore, most could afford to ride out the downturn, as emotionally challenging as that might be.
- Investing in the market at a peak and just ahead of a big stock market downturn is truly bad luck, but a risk that can be potentially mitigated with a dollar cost averaging strategy.

This analysis reinforces the importance of staying disciplined and sticking with your long-term plan. Too many investors buy in at high prices and panic when stocks drop, violating Warren Buffett's famous maxim:

> *Be fearful when others are greedy,*
> *and be greedy when others are fearful.*

In nearly 90 years of history, only four times did the wait to return to all-time highs take more than 5 years and only once did it take more than 7.5. That's painful, but for a long-term investor, it may be acceptable.

So even if an individual invested all of his money at a long-term high, losses were recouped well within the typical longer-term investor's time horizon, with the exception of the Great Depression. However, those looking to enter the market have another option that may considerably reduce this time frame, dollar cost averaging.

3 WITH ONE EXCEPTION, TIME TO RECOUP LOSSES AFTER BUYING AT A PEAK HAS FALLEN WITHIN THE LONG-TERM HORIZON OF MOST INVESTORS

	Cumulative % Decline	# Years to Recoup	Start Date	End Date
Longest Time to Regain All-Time High	-86%	25.0	09/16/29	09/22/54
Second Longest	-48%	7.5	01/11/73	07/17/80
Third Longest	-49%	7.2	03/24/00	05/30/07
Fourth Longest	-57%	5.5	10/09/07	03/28/13
Fifth Longest	-36%	3.3	11/29/68	03/06/72

Source: LPL Financial, Bloomberg, S&P 500 Index 07/11/16

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DOLLAR COST AVERAGING

Dollar cost averaging can dramatically reduce the time it takes for the investor to dig out of that initial hole and get back to even—if unlucky enough to have purchased at a peak. Purchasing during a downturn results in buying more shares at lower prices, which helps lower the average price.

A simple example can help illustrate the power of dollar cost averaging if an investor enters the market at the worst possible time—a significant peak. Instead of investing a lump sum, say $12,000, all up front on one specific date (such as the market peak in October 2007), an individual could have invested $1,000 per month, starting the same date, until reaching that same target dollar amount of $12,000 (over a total of one year).

An investor using a dollar cost averaging approach may substantially shorten the time to recoup losses [Figure 4]. Returning to the fourth-longest time to recoup from a market peak and buying just ahead of the 2008 financial crisis, an investor would have shortened the recovery back to even by just over one full year—a noteworthy difference. Buying on regular intervals can potentially lessen the impact of buying at a market peak.

4 DOLLAR COST AVERAGING MAY SUBSTANTIALLY SHORTEN INVESTMENT RECOVERY TIME

	Years	Break-Even Date
One Lump Sum Investment	5.5	03/28/13
Dollar Cost Averaging	4.4	02/23/12

Source: LPL Financial, Bloomberg, S&P 500 07/11/16

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This hypothetical illustration is for informational purposes only, and does not take the deduction of fees nor the reinvestment of dividends into account. A similar analysis using different indexes would have yielded different outcomes. Past performance is not indicative of future results.

CONCLUSION

We expect the now more than seven-year-old bull market to potentially continue (please see our *Midyear Outlook 2016: A Vote of Confidence* publication), but that does not remove the nervousness investors may feel buying stocks at or near all-time highs. Nonetheless, historical data provide reassurance that investors with time horizons of more than five years stand a very good chance of making money over that time period, even if they have the misfortune of buying ahead of a downturn. This is especially true for investors taking a gradual approach and using dollar cost averaging.

Bottom line, don't let those headlines about all-time highs scare you and keep you from investing to pursue your long-term financial goals. ■

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There is no assurance that the techniques and strategies discussed are suitable for all investors or will yield positive outcomes. The purchase of certain securities may be required to affect some of the strategies.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

DEFINITIONS

Dollar cost averaging refers to a program of investing a fixed dollar amount on a regular schedule, rather than the traditional method of investing all funds in one transaction. Given that the dollar amount is fixed more shares are purchased when prices are lower, and fewer are purchased when prices are high, though there is no guarantee that a dollar cost averaging plan will outperform a single lump sum investment.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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