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Seven Strategies for Investing at Market Peaks

One of these peaks will be *the peak*, but predicting that ahead of time is not easy.

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5 August 17, 2017, 10:00 AM EDT

Markets are making new highs more often. *Photographer: Drew Angerer/Getty Images*

The S&P 500 Index has recorded more than 150 new all-time highs since eclipsing its previous peak in late March of 2013. In 2017 alone, there have been 30 new record highs through the end of last week. To put this into perspective, there were only 13 new highs for the entire decade of the 2000s.

When you combine a stock market that continues to see so many new highs with above-average valuations <https://www.bloomberg.com/view/articles/2017-03-03/what-to-make-of-these-twice-in-history-s-p-500-valuations> , investors get worried. One of these peaks will be *the peak*, but predicting that ahead of time is not easy. Life would be much easier if there were more bargains available and higher interest rates, but we have to invest in the markets as they are, not as we wish they could be.

Here are some options:

Rebalance. A simple portfolio that started out 2009 with 60 percent in U.S. stocks and 40 percent in U.S. bonds would now have close to 80 percent in stocks and 20 percent in bonds. Going from a 60/40 portfolio to an 80/20 portfolio is a huge change in risk profile and loss potential. There's no reason to set target asset allocation weights if you're not going to periodically rebalance back to your preset amounts on occasion.

Over-rebalance. If you're nervous about stocks, you could put more money in underperforming assets. Value stocks have underperformed growth stocks by more than 3 percentage points annually over the past 10 years. The relative performance is even worse overseas. U.S. stocks have outperformed European stocks by 29 percent, 44 percent and 100 percent over the past three-, five- and 10 year periods. U.S. stocks have outperformed emerging markets by 28 percent, 73 percent and 91 percent over those same intervals. Investors looking to take advantage of mean reversion could allocate more of their portfolios to value and international stocks.

Avoid complexity. Someone is going to be a hero coming out of the next market downturn, but figuring out who that will be is like playing the lottery. There are plenty of complex hedging techniques, bear market funds, leveraged ETFs and VIX products you can invest in, but most require incredible foresight to work. You can be "right" in the markets and still not make any money, as mistimed trades, volatility and costs can often eat up good investment ideas. The easiest way to hedge risk in the markets is to simply take less risk by raising more cash or investing in more high-quality bonds and fewer equities.

Have enough cash to make it through a rainy year or three. One of the worst positions to be in as an investor is being a forced seller of your shares at an inopportune time. You give yourself a margin of safety by having enough cash on hand in safe holdings to see you through a disruption in the markets or economy. Low interest rates mean you won't earn much on your cash holdings, but the peace of mind in knowing you can meet your expenses in a downturn is worth more than a few percentage points in returns. This money can also be used as dry powder when the next downturn comes around.

DCA and diversify. From a psychological standpoint, there are few strategies that work better than dollar cost averaging into a diversified portfolio of assets. This isn't a strategy you can brag about to your friends, but making investment contributions at periodic intervals regardless of price is one of the simplest ways to avoid making mistakes or over-thinking investment decisions.

Buy and hold. To paraphrase Winston Churchill, buy and hold is the worst investment strategy, except for all the others. Being a long-term investor is easy when things are going up. But to be a true buy-and-hold devotee, you have to both buy and hold when things are going down, as well. This is not for everyone because it's emotionally challenging, but it is a great way to decrease transaction costs, taxes and market timing errors.

Embrace the momentum. One of the hardest things to wrap your head around as an investor is that all-time highs <https://www.bloomberg.com/view/articles/2017-01-30/sometimes-the-dow-s-peaks-are-followed-by-more-peaks> in stocks are typically followed by more all-time highs. One way to take advantage of this is by investing in momentum <http://awealthofcommonsense.com/2016/05/the-sp-500-is-the-worlds-largest-momentum-strategy/> or trend-following strategies <http://awealthofcommonsense.com/2017/04/my-evolution-on-asset-allocation/> . Momentum is based on the idea that assets that have performed relatively well (or poorly) recently will continue to perform well (or poorly) going forward, at least for a short period of time, because markets can be irrational in the short run. These strategies have been proven to work but typically require a rules-based framework to keep the emotions out of the equation.

Each of these approaches has its drawbacks, but there are no perfect investment strategies. The best thing you can do as an investor is to pick the one that works for you from a psychological standpoint. Even the greatest investment strategy in the world is pointless if you can't stick with it.

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