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With returns on cash likely to erode as the global interest-rate-cutting cycle progresses, CIO recommends that investors develop a disciplined plan for putting cash to work. (UBS)

Why investors needn't fear all-time highs in equity markets

03 September 2024, 5:47 pm CEST, written by UBS Editorial Team

The S&P 500 closed out a volatile August by rallying to within 1% of its all-time high of 5,667 set on 16 July. The index has now gained 18% year-to-date. That's good news if you're invested, but it can be frustrating—and expensive—for those waiting for a pullback to put cash to work. And with stocks near record highs, many investors are also concerned about the risk of suffering large and painful drawdowns.

Looking at US large-cap stocks' (i.e., the S&P 500) monthly total returns since 1945, our analysis suggests that, over the long term, drawdown risks may not be as great as some investors might think:

Drawdown risks from random starting points aren't as high as commonly perceived. Assuming an investor bought the US stock market at a random time, in 28% of cases they would at no future point have seen their investment (including dividends) trade in the red. In just over half of cases, an investor would at no point have seen their investment suffer a greater-than-5% drawdown, and in only 19% of instances would they have experienced a "personal bear market" of a greater-than-20% loss on their newly made US equity investment.

Losses are historically *less* likely if stocks are at an all-time high. Perhaps surprisingly, drawdown risks from all-time high starting points have been lower than those from random starting points. In 32% of cases of buying in at an all-time high, an investor would at no point have seen their investment (including dividends) trade at a loss. In just 15% of cases would an investor have seen their investment experience a greater-than-20% fall (compared to a 19% figure for the same analysis carried out at a random starting point).

The fact that all-time highs are often followed by further gains may seem counterintuitive. But investors should remember that record highs aren't the same as market peaks. For every 2000 or 2007 when buying in at all-time highs would have

subsequently felt like a bad idea, there were many more times like 1982, 1992, 1995, 2013, 2016, mid-2020, and early 2024, when investors were rewarded for keeping faith.

Balanced portfolios have lower drawdown risks than pure equity portfolios. If we consider a newly bought 60%/40% (US large-cap equities/US government bonds) portfolio: In two-thirds of cases, an investor would at no future point have seen their investment (including dividends) suffer a greater-than-5% drawdown. In just 5% of instances would an investor have suffered a greater-than-20% drop in their investment from their purchase level. While history is no guarantee of future performance, it does suggest that balanced portfolios experience fewer large losses than stocks alone.

These insights are important, in our view, because many investors overestimate the potential value of timing markets, and underestimate the cost of being uninvested while waiting for an opportunity to buy stocks on a dip. We believe putting cash to work straight away is usually the best policy, because historically the odds are against our hope of being able to buy in at a lower level.

With returns on cash likely to erode as the global interest-rate-cutting cycle progresses, we recommend that investors develop a disciplined plan for putting cash to work. This may include dollar-cost-averaging or phase-in strategies to help navigate market entry. Investors can also consider structured investments and options strategies such as call buying and put writing, which can mitigate the opportunity cost of phasing into the market. We believe the current environment of falling inflation, likely lower interest rates, and moderate economic growth is constructive for equities and bonds alike.

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Original report - **Why investors needn't fear all-time highs in equity markets, 2 September 2024.**

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