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MarketWatch Weekend Investor

Even Experienced Market Timers Are Searching for Better Formula

By MARK HULBERT

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On July 7, 1999, the Dow Jones Industrial Average closed at 11187.36. That's 37.14 points higher than Friday's close and means that nearly seven years of the stock market's ups and downs have led just about nowhere.

Given that track record, some advisers have started seriously entertaining the idea that we're replaying the 16-year nightmare that lasted from 1966 to 1982, at the end of which the DJIA was no higher than it was at the beginning.

As investors mull this depressing possibility, many have decided to follow the lead of market timers who promise to catch the rallies and avoid the declines and thus produce a profit even when the stock market goes nowhere.

One of the more popular of such timers is Douglas Fabian, editor of a newsletter called Successful Investing, who employs a widely known trend-following system based on moving averages. Unfortunately, the newsletter's track record casts serious doubt on whether such an approach can produce the returns that its followers are hoping for. Indeed, Mr. Fabian has spent the past five years tinkering with his newsletter's system to try and get better results. Mr. Fabian didn't respond to a request for comment.


Mr. Fabian's newsletter was inaugurated in the 1970s by his father, Richard, at which time it was called the Telephone Switch Newsletter. Douglas took over the newsletter in 1992.

The trend-following, market-timing system that the newsletter made famous was based on the 39-week moving average. That system recommended being invested in stocks whenever the stock market was trading above its average level of the previous 39 weeks, and otherwise being in cash. In 1980, when the Hulbert Financial Digest began monitoring the elder Mr. Fabian's performance, he assured followers the system would produce a 20% annualized return over any given five-year period.

A funny thing happened on the way to the bank, however. Consider the performance of a hypothetical portfolio that switched between the Dow Jones Wilshire 5000 Total-Return index and a money-market fund on signals from Mr. Fabian's 39-week moving-average system. In only 10% of the past two decades' rolling five-year periods did this portfolio satisfy the elder Mr. Fabian's assurances. In fact, in some of those five-year periods it actually lost money.

Investors will find it particularly discouraging that this 39-week moving-average portfolio lost money during the 2000-2002 bear market, since it is during major declines that investors most want market timers to protect them. Between the stock market's March 2000 high and its October 2002 low, according

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to the Hulbert Financial Digest's calculations, this portfolio shed more than a quarter of its value. As a result, this hypothetical timing-only portfolio over the past 15 years has lagged a simple buy-and-hold strategy by a full percentage point per year on an annualized basis.

The 39-week moving average is just one of many possible market-timing systems, however, and investors no doubt will continue looking for other strategies to provide them with the hope that they can capture the upside and avoid the downside in an otherwise flattish market. But when pursuing such strategies, there are several additional factors that should give pause. Perhaps the most compelling: Despite its mediocre record over the past 15 years, Mr. Fabian's newsletter has one of the best market-timing performances of any that the Hulbert Financial Digest has tracked since 1980, when it began monitoring the performance of the investment newsletter industry.

To be sure, this doesn't mean that better market-timing systems cannot be found. But many of the apparently superior market-timing systems that I see advertised are the outgrowth of what statisticians refer to as data mining. Such systems have little real value, since by continuously poring over the historical record it isn't hard to "discover" alleged patterns in the data. Not surprisingly, of course, those patterns almost always stop working the moment investors try to follow them in real time.

Investors hoping for a better market-timing system should also bear in mind that Douglas Fabian continues to search for a better system. His decision to stray from a strict reliance on the 39-week moving average must have been a painful one, since his father devoted much of his investment career to arguing how essential it is to stick to that system through thick and thin.

In any case, according to the Hulbert Financial Digest's performance monitoring, the alternate market-timing approaches that Fabian the son has pursued in his newsletter have on average not performed significantly better than the 39-week moving average system from which he deviated.

I fully recognize that hope springs eternal, and that by no means does Mr. Fabian's track record put an end to the market-timing debate. But it nevertheless should be sobering to us all that even one of the most experienced of market timers has had such difficulty finding a successful system.

Herb Greenberg is a senior columnist at MarketWatch, a financial-news Web site owned by Dow Jones, publisher of The Wall Street Journal. He doesn't own stocks (except his employer's), nor sell stocks short or invest in hedge funds.

Write to Mark Hulbert at mark.hulbert@dowjones.com¹

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(1) <mailto:mark.hulbert@dowjones.com>

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