When Holding is the Hardest Part

"The easy money has been made" is one of my least favorite sayings about investing.

Making money in the markets is never easy. In fact, I would argue that it's always hard.

Convincing yourself to buy during a bear market is hard. Convincing yourself to hold during a bull market is hard. Figuring out what to do during a sideways market is hard. Watching others make more money in the markets than you is hard. Following a plan when things aren't going your way is hard. There's always going to be a reason to do something that goes against your best interests.

Howard Marks wrote about this idea in a memo for Oaktree Capital a couple years ago:

Two of the main reasons people sell stocks is because they go up and because they go down. When they go up, people who hold them become afraid that if they don't sell, they'll give back their profit, kick themselves, and be second-guessed by their bosses and clients. And when they go down, they worry that they'll fall further.

Where we are in the each cycle usually determines what the hard part is at that moment. The hardest part for the past few years has been holding on during a rising market. Investors witnessed two epic market crashes in the span of eight years to kick off the start of the century. Those types of losses leave scars on an investor's psyche.

So as stocks have continued to rise people have become more and more nervous about another crash. There's been a relentless onslaught of people calling for a recession or market crash at every turn. It's hard for investors to know who to trust and what to do in these situations where markets continue to rise year after year.

Here's what we know when it comes to investing in stocks:

- We know that stocks are the best asset class for earning long-term returns above inflation.
- We know that stocks, on average, are up roughly three out of every four years.
- We know that stocks occasionally exhibit bone-crushing volatility.
- We know that, on average, stocks fall by 5% roughly three times a year.
- We know that, on average, stocks fall by 10% roughly once a year.
- We know that, on average, stocks fall by 20% or more roughly once every 3-5 years.

The problem is that we don't know exactly when this volatility will rear its ugly head and we have no idea what will cause a 5% "healthy" correction to turn into a 30% "unhealthy" bear market.

Marks also said in that same memo that, "it’s not the things you buy and sell that make you money; it’s the things you hold.”

Holding during a bull market is difficult because you're always worried about when the music is going to stop. And holding during a bear market is always difficult because you never know how bad things can get.

So the question becomes: How do you ensure you're able to hold during a bull market but survive during the inevitable bear market?

Personally, I wouldn't be able to handle either situation without a rules-based process in place to guide my actions. Trying to make investment decisions in real time during a rising or falling market without a set of guidelines in place is just asking for trouble. Emotion is the enemy of every portfolio and it rarely allows an investor to make rational decisions in the moment.

I've witnessed far too many investors outsmart themselves by trying to outsmart the markets. It doesn't work. George Soros's phantom back pains aren't going to magically appear for you before the next bear market hits. You have to have a plan in place *before* something bad occurs to understand what you'll do regardless of what happens next.

The obvious answer for most investors is to set a reasonable asset allocation, rebalance on occasion, and mostly do nothing the rest of the time. Holding can still become an issue with this strategy if you don't set the correct allocation ahead of time or if you don't have the ability to see it through. Buy and hold is so simple yet very hard to pull off because of this.

My own thinking on how do deal with this paradox of wanting to be invested during bull markets but decrease the psychological impact of bear markets has definitely evolved over the years. In a post later this week I'll discuss the evolution of my thinking on this topic and what it means for my personal investment philosophy.

Further Reading:
The Dual Mandate of an Investment Advisor
The Bedrock of Portfolio Management