Why Is Market Timing So Difficult?
by F. Louis Floyd

Abstract

Market timing efforts involve attempts to predict both future price behavior and trend changes, using some form of modeling to create the forecast. Past efforts have had limited success for a number of reasons:

- At best, forecasts actually produce lagging results, because they cannot detect future trend changes. In effect, one ends up chasing rather than anticipating trend changes.
- The data employed in modeling efforts contain considerable noise which conceals the underlying signals of interest. Since noise never repeats itself, failure to first filter that noise results in predictions with little validity.
- Noise levels decline with increasing aggregation of components, and with increasing time intervals of both measurement and observation. Time intervals commonly employed are far too short to contain adequate replication of the features (trend changes) of interest.
- Modeling inevitably requires a number of simplifying steps, which are commonly linear in nature, while real world data mimic other geometric shapes. The implications of bell-shapes, S-shapes, bathtubs, and exponential curves will be discussed.
- Even validation efforts through back-testing have their own set of problems. For example, historical analysis is strongly susceptible to survivorship bias, which can materially distort the relative success of alternative strategies.

So what can one realistically expect from the wild and wooly world of market timing? In the speaker’s view, the best alternative is to switch from trying to predict the future to early detection of what is actually happening, coupled with fast following decision strategies. Appropriate noise filtering is essential to this effort. As with conventional timing efforts, the goal is to minimize the impact of major bear markets, which have the single greatest adverse impact on one’s financial health. Technical analysis can be a useful means of graphically illustrating both events and their context, which helps in implementing any timing strategy.
Illustrations

These are a few slides that illustrate some of the issues to be covered:

Assigning daily causes is an exercise in futility

Noise is both inversely and exponentially related to aggregation and time interval

Even companies’ internal forecasts are lagging indicators

Fat tails more accurately estimate actual risk

The S-Shaped Curve

Miner’s Plot: Different Stages in Product Lifetime

References

These are the most directly useful reference books for this talk:

- The Evolution of Technical Analysis
- BUBBLES and How to Survive Them
- Pandora’s Risk
- The Logic of Averages

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