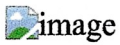


WSJ Print Edition



Fund Managers Are All-In on the Market

Nobody rings a bell at the top or the bottom of the market, but there are useful clues.

Unfortunately, they are loudest and clearest when many investors are too scared to act on them. That plays a big role in harming their long-run returns.

The numbers can be seen in fund data. Morningstar's annual "Mind the Gap" report calculates that the average dollar invested in U.S. mutual and exchange-traded funds earned 7% annually in the past 10 years, or 1.2 percentage points less than those funds' total return. The rolling 10-year gap has been 4% or more for stock funds in recent years.

We know that much of that shortfall occurs after stocks have plunged. The failure to be fully invested causes investors to miss some of the market's best days, half of which have been during bear markets or soon after they end. Benefiting from them means topping up stockholdings when others are selling. Instead, investors hold lots of excess cash to sleep better at night.

Not included in Morningstar's data is the fact that the pros managing those funds make the same mistake. According to Bank of America's regular surveys of fund managers, cash as a percentage of assets under management hit peaks during months such as May 2000, December 2008, June 2012, April 2020, October 2022 and this past April—all after stocks had just suffered big selloffs.

That is partly explained by fund managers raising cash to meet anticipated redemptions, but it also reflects unhealthy pessimism.

The opposite is happening right now: Cash levels recently hit their lowest as a percentage of assets under management in more than a decade. Another cyclical low was in early 2000, just before the tech bubble burst. The trough before that was in the early 1970s, right before another nasty bear market.

Low fund cash levels aren't exactly ringing a bell, but they add to evidence that stocks are prone to a reversal.

Other hints include near-record valuations and the frenetic buying of leveraged funds by less-experienced investors.

Like funds, many individuals are taking more risk than they will be comfortable with when this bull market suffers a setback. The smart way to react to those signs of complacency is sticking to a sound plan, not trying to get ahead of that downturn by sitting on too much cash today. Bull markets are long and the warnings can ring frustratingly early.

As star mutual-fund manager Peter Lynch put it: "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections."

His stellar returns are a case in point. Because of poor timing, the average investor in his fund earned only a fraction of them. They got fearful or greedy at the wrong time instead of staying put.