



## Is Calling the Top of the Stock Market Impossible?

### Description

During a bull market, it can feel as though share prices will rise in perpetuity. History, though, shows that they do not. In fact, a bear market has historically followed a bull market just as night follows day. But the problem lies in determining exactly [when this will happen](#).

### Herd mentality

Of course, one of the difficulties in trying to call the top of the stock market is the behaviour of other investors. During a bull market, various commentators and investors invariably become overconfident in their returns. As such, they believe that these returns are not only possible, but also expected in the long run. Overcoming this belief can be difficult, as it means potentially missing out on short-term gains that may be on offer as a bull market continues.

However, an investor who is able to focus on facts and figures rather than listening to his or her peers can take a major step towards being able to call the top of the stock market.

### Valuations

One method of deciding when share prices are too high is to focus on [valuations](#). While the value of any company is subjective, it is possible to gauge whether it is historically high or low. Take, for example, the current state of the **S&P 500**, which has enjoyed almost a decade of significant gains and has been able to reach record highs along the way. The S&P 500 currently has a price-to-earnings (P/E) ratio of around 23. While its P/E ratio has been higher in its 90-year history, those occasions can be counted on one hand and have never lasted for an extended period.

Certainly, the S&P 500 could move higher. However, the reality is that there is unlikely to be another nine-year Bull Run ahead. This means that investors may now wish to reduce their exposure to companies and sectors that appear to be the most overvalued on a relative basis.

## Closed for business

Clearly, attempting to time the market is immensely challenging. It is difficult to determine how significant particular risks could become over the medium term. However, one method of deciding whether a stock, industry or even stock market is worth buying over the long term is to imagine that once purchased, no sales can be made for five years. This method should ensure that an investor focuses not only on the potential for further gains in the continuation of a bull market, but also considers the risk of a potential bear market within the ensuing five years.

## Takeaway

While accurately predicting the top of the stock market may require some degree of luck, focusing on valuations can provide guidance on whether buying or selling is the best move for an investor to make. By focusing on the long term as well as ignoring the views of the investment herd, it is possible to take advantage of the peaks and valleys of share prices.

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## Date

2025/08/27

## Date Created

2017/12/31

## Author

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