The Merits of buy and Hold Strategy in International Financial Markets

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ABSTRACT

In the dynamic world of investment, numerous strategies have emerged and keep evolving over time. One such strategy that has stood the test of time is the buy and hold strategy which is favored by many successful long-term investors which focuses on acquiring quality assets and maintaining a long-term investment horizon. A buy and hold strategy is a long-term investment approach that involves purchasing assets and holding onto them for an extended period, regardless of short-term market fluctuations. Understanding the merit of this strategy in financial markets can empower investors to make informed decisions and develop a disciplined investment mindset for achieving their financial goals. Accordingly, the aim of this study was to empirically explore the merits of a buy and hold strategy in financial markets due to its perceived significant impact for active market participants. A Sharpe ratio was utilized for six financial markets from June 13, 2018, to June 13, 2023. The findings revealed that market participants can use a buy and hold strategy in the Nasdaq, CAC 40 and Nikkei 225 to enhance the value of their portfolio over a long-term period. Upon selecting a particular risk tolerance and investment horizon, market participants may earn significant returns on their portfolios.

Keywords: Buy and Hold Strategy; Financial Markets; Fundamental Analysis; Behavioral Finance.

1. INTRODUCTION

A buy and hold strategy have long been recognized as a prominent investment approach for those seeking long-term wealth accumulation and financial security. Rooted in the principles of patience, discipline, and a steadfast commitment to quality investments, the strategy involves purchasing securities and holding them for an extended period irrespective of short-term market fluctuations (Gründl, Dong & Gal, 2016). This approach stands in contrast to active trading strategies that aim to profit from short-term market movements and market timing (Enow, 2023). Instead, the buy and hold strategy advocates for a patient and long-term perspective, capitalizing on the potential growth and compounding returns of investments over time (Sanderson & Lumpkin-Sowers, 2018). This concept has gained traction due to its alignment with fundamental principles of investing and its potential to deliver favourable outcomes for investors. It operates on the belief that markets are inherently efficient, meaning that prices reflect all available information making it difficult to consistently outperform the market through frequent trading through fundamental analysis (Fama, 1965). This view finds support in the Efficient Market Hypothesis (EMH), which posits that all relevant information is rapidly incorporated into security prices, leaving little room for investors to consistently exploit mispricing (Buzzacchi & Ghezzi, 2023).

Another influential factor shaping the buy and hold strategy is the field of behavioural finance which recognizes that investors are subject to cognitive biases, emotional decision-making, and herd mentality (Weixiang et al., 2022). These factors can lead to suboptimal investment decisions driven by short-term market fluctuations rather than long-term fundamentals (Enow, 2023). A buy and hold strategy have its emphasis on patience and discipline and aims to counteract these behavioural biases by encouraging investors to maintain a long-term focus, tune out short-term market noise, and adhere to their investment strategy regardless of market fluctuations (Enow, 2022). The historical background of this concept dates to era of Benjamin Graham who is considered the father of value investing and widely regarded as one of the most successful investors of all time. Graham's success, along with the compelling historical performance of the stock market over the long term has provided a solid foundation for the buy and hold strategy's appeal. In recent years, empirical studies have shed further light on the buy and hold strategy's efficacy (Hui & Yam, 2014; Teimoori-Boghsani et al., 2023). The authors cited above demonstrated that over long investment horizons, a buy and hold approach has the potential to deliver favourable risk-adjusted returns while minimizing transaction costs and the psychological stress associated with frequent trading. According to Zaznov et al. (2022), a buy and hold strategy can outperform alternative active trading strategies, especially after accounting for fees and transaction costs. Therefore, the aim of this study was to provide empirical evidence on the merits of a buy and hold strategy relating to long-term investing in financial markets. More specifically, this study investigates the following research question; Which financial markets provide long-term profit potential for investors that adopt a buy-and-hold strategy? By providing answers to the abovementioned research question, this study will equip investors with the knowledge and insights necessary to adopt the buy and hold strategy for financial markets as their long-term investment objectives. The section below highlights the literature review.

2. LITERATURE REVIEW

A buy and hold strategy involve purchasing securities such as stocks or bonds with the intention of holding onto them for an extended period typically years or even decades (Enow, 2023). This strategy rests on several fundamental principles and it encourages patience and a focus on the intrinsic value of the asset rather than temporary price volatility. Historical evidence supports the efficacy of the buy and hold strategy (Hui & Yam, 2014; Teimoori-Boghsani et al., 2023). Studies on stock market performance such as the seminal work by Siegel (2002) in his book *"Stocks for the Long Run"* demonstrate the consistent upward trend of stock markets over extended periods. Despite short-term market downturns and economic fluctuations, the general trajectory of the stock market has been positive which has provided ample opportunities for buy and hold investors to realize long-term capital appreciation (Hatmanu & Cautisanu, 2021). Another key advantage of the buy and hold strategy is its simplicity which offers investors a straightforward approach that requires minimal trading activity and a long-term perspective. This simplicity also allows investors to save time and effort that would otherwise be spent on continuous research, monitoring, and trading. Additionally, the buy and hold strategy is known for its potential to deliver significant tax advantages. By holding onto investments for an extended period, investors may benefit from long-term capital gains tax rates, which are typically lower than short-term capital gains rates. This can have a positive impact on an investor's after-tax returns, allowing them to retain a larger portion of their profits. Moreover, the buy and hold strategy encourages a disciplined approach to investing as it requires emotional resilience. Investors must withstand short-term market fluctuations and resist the temptation to make impulsive decisions based on market noise. By maintaining a long-term focus and avoiding reactionary behavior, investors are more likely to avoid detrimental actions driven by fear or greed.

While the buy and hold strategy has its merits, it is essential to recognize that it is not without potential drawbacks and considerations. One significant criticism is that it may lead to missed opportunities (Lo & Remorov, 2017). By holding onto investments for extended periods, investors may fail to capitalize on short-term market movements or individual stock performance that could provide higher returns. Moreover, a buy and hold strategy requires careful selection and monitoring of investments which does not mean blindly buying and holding any security without considering its underlying fundamentals. Thorough fundamental analysis is crucial to identify quality investments with the potential for long-term growth. Neglecting this aspect can lead to holding onto underperforming or deteriorating assets that may hinder overall portfolio performance. Another consideration is the importance of periodic portfolio review and rebalancing. While the buy and hold strategy advocates for minimal trading, it does not mean complete inaction. Market dynamics and individual company circumstances can change over time, requiring investors to reassess their portfolio holdings periodically. This ensures that the portfolio remains aligned with the investor's risk tolerance, goals, and evolving market conditions. However, a buy and hold strategy has proven to be a compelling investment approach with a solid historical foundation. Its simplicity, potential for tax advantages, and encouragement of disciplined long-term thinking are among its notable advantages. The merits of this strategy are provided in the next two sections.

3. METHODOLOGY

A sharpe ratio was used to investigate the merits of a buy and hold strategy in the Johannesburg stock exchange (JSE index), Nasdaq index, the French stock market index (CAC 40 index), Frankfurt stock exchange (DAX index), Japanese stock index (JPX-Nikkei 225) from June 13, 2018 to June 13, 2023.

Sharpe ratio takes into account both the return and the risk of an investment (Kozak, 2017). Sharpe ratio provides a way to compare investments with different levels of risk and determine whether the return generated is commensurate with the amount of risk taken (Camilleri & Farrugia, 2018). This allows investors to evaluate the risk-return trade-off across various assets or strategies, enabling informed decision-making. In so doing, it condenses multiple dimensions of an investment's performance into a single metric, making it easy to compare and rank different investments. Its popularity stems from its simplicity and intuitive interpretation, which is commonly used as a tool in the investment community. Upon calculating the risk and return trade off from the number of runs, the sharp ratio was used to benchmark the performance for a buy and hold strategy to that of a support and resistance style where investors seek to profit from frequent trading within a particular range. A sharp ratio is given by;

$$S_r = \frac{Return}{Risk}$$

The required data was daily share prices retrieved from yahoo finance which provides real time data. The section below highlights the results and discussion.

4. RESULTS AND DISCUSSION

The results and analysis are presented and discussed below in table 1.

Table 1: Buy and Hold Strategy Results

JSE			**Nasdaq**		
	Support	Resistance		Support	Resistance
Threshold	20%	80%	Threshold	20%	80%
Total	267	249	Total	230	246
Broken	0	0	Broken	3	1
Fulfilled	267	249	Fulfilled	227	245
Up	135	128	Up	118	137
Down	132	121	Down	112	109
	B&H	S&R		B&H	S&R
Return	-20.33%	7.75%	Return	29.65%	-10.01%
Risk	26.20%	17.87%	Risk	25.77%	16.20%
Sharpe ratio	-77.60%	43.34%	Sharpe ratio	115.05%	-61.83%
CAC 40			**Nikkei 225**		
	Support	Resistance		Support	Resistance
Threshold	20%	80%	Threshold	20%	80%
Total	218	247	Total	278	251
Broken	2	4	Broken	0	1
Fulfilled	216	243	Fulfilled	278	250
Up	128	140	Up	132	152
Down	90	107	Down	146	99
	B&H	S&R		B&H	S&R
Return	17.02%	-4.04%	Return	19.09%	-31.45%
Risk	20.83%	12.57%	Risk	19.46%	12.59%
Sharpe ratio	81.69%	-32.10%	Sharpe ratio	98.11%	-249.83%
DAX			**BIST100**		
	Support	Resistance		Support	Resistance
Threshold	20%	80%	Threshold	20%	80%
Total	246	242	Total	310	151

Broken	1	0	Broken	2	5
Fulfilled	245	242	Fulfilled	308	146
Up	123	128	Up	182	88
Down	123	114	Down	128	63
	B&H	S&R		B&H	S&R
Return	11.05%	13.57%	Return	-79.16%	-9.26%
Risk	21.39%	13.52%	Risk	51.92%	15.81%
Sharpe ratio	51.68%	100.38%	Sharpe ratio	-152.4%	-58.59%
B&H (buy and hold strategy); S&R (Support and Resistance strategy)					

The findings in table 1 above presents interesting results from the data analysis. In the JSE, 267 days of support was identified as opposed to 249 days of resistance. This means that for a period of 5 years, there were 267 days where the price level at which the demand for JSE was considered strong enough to prevent it from declining further. On the contrary, there were 249 days in which the price level at which the supply of the JSE stock price was considered strong enough to prevent it from rising further. A much lower figure was observed in the Nasdaq, CAC 40, DAX and Nikkei 225. However, a higher support and resistance days was observed in the BIST100 as seen in table 1. No violations in the support and resistance levels was found in the JSE while three violations of the support and one violations of the resistance levels was observed in the JSE. Two violations in support level and four violations in resistance was observed in the CAC 40 while one violation in support level and zero violations in resistance was observed in the DAX. In the Nasdaq, three violations in support level and one violation in resistance was observed. The stock market price is likely to increase than decrease following a support and resistance signal in the JSE, Nasdaq, CAC 40, DAX and BIST100 which was evident from the Up and Down values. However, the stock market price is rather likely to decrease following a support signal in the Nikkei 225. Looking at the returns, a support and resistance strategy realises a significantly high returns and lower risk in the JSE and the DAX. Most importantly, a buy and hold strategy is much more superior in the Nasdaq and CAC 40. On the contrary, both strategies are not useful in the BIST100 as seen in negative Sharpe ratio value. while market participants in the JSE and DAX can realise abnormal profits by monitoring price movements around their support and resistance levels.

5. CONCLUSION

A buy and hold strategy plays a significant role in financial markets enabling traders to make informed investment decisions. Despite its limitations, a buy and hold strategy remains a valuable tool as traders can utilize this approach to devise trading strategies as it represents a time-tested approach to investing that focuses on patience, discipline, and a long-term perspective. By embracing this strategy, investors have the potential to benefit from the inherent growth of the market while minimizing the impact of short-term market noise. The aim of this study was to empirically explore the merits of buy and hold strategy in international financial markets. The findings revealed that this strategy can be very useful in the Nasdaq and CAC 40. While the buy and hold strategy has its merits, it is essential to acknowledge its limitations and areas that warrant further research. A Buy and hold strategies may face challenges during periods of heightened market volatility. Extreme market downturns can lead to substantial losses, and holding onto investments during these times requires resilience and a long-term perspective. Further research could focus on strategies to manage and mitigate the impact of market volatility on buy and hold portfolios. Also, behavioural biases can influence investment decisions and affect the implementation of a buy and hold strategy. Studying investor behaviour, cognitive biases, and the impact of emotional decision-making can provide insights into how investors adhere to or deviate from buy and hold principles. Identifying and addressing behavioural challenges can contribute to improving the effectiveness of the strategy.

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