Is it riskier being in the market or out?

What's the greater risk, holding stocks or sitting with cash? Most would say it's riskier to own equities, but the answer isn't that simple because it depends on your time horizon.

Yes, stocks are volatile so if you need the money within the next few years then it is more risky to be invested. If you are saving for retirement, or if you are investing for a newborn's college tuition, however, then it is riskier being out of the market compared to being in. Let me explain.

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If you are sitting on the sidelines for a long period, then each year you lose purchasing power to inflation. If the money is for retirement, healthcare costs are rising far faster than your money-market fund. If the funds are for college, tuition will increase faster than your portfolio.

Here's why it's riskier being out of the market: Stocks go up over the long-term. In fact, for 20-year holding periods, stock returns have never fallen below inflation. The same can't be said about bonds.

There was a 20-year period when yields on bonds trailed the inflation rate by as much as three percent. How about gold? There have been several long-term periods where gold has lost value.

Every stock market "correction" and bear market has been followed by a move to new highs. Since World War II, the average annual real (after inflation) return on stocks is 6.4 percent.

Yes, stocks are volatile. But, the longer the period the less volatile the market. This year is a good example. If you stared at the market daily, you'd see (and feel) the market's early-year strength followed by the recent 10-percent plunge.

On a daily basis, prices were very volatile. But if you simply looked at prices at the end of last year compared to prices today you'd see little change.

Investing is as much a psychological challenge as an intellectual challenge. Those who track their portfolio daily often do worse than those who own good broad-based index funds (like the one we covered last week). That's because they often get too aggressive after stocks are strong and panic out of the market when stocks are weak.

If you have a long-term time horizon and aren't emotional about short-term swings, then investing is easy. Why? Because over the long run stocks go up. Next week I'll cover good buy-and-hold ETF investments.

David Vomund is an Incline Village-based fee-only Registered Investment Adviser. Information is found at www.VomundInvestments.com or by calling 775-832-8555. *Past performance does not guarantee future results. Consult your financial advisor before purchasing any security.*