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I Am A Jelly Doughnut

Readers of a certain age will remember John F. Kennedy's stirring June 1963 speech in West Berlin. President Kennedy enumerated groups who doubted the steadfastness of the United States against the enemies of freedom, and after each group was listed, he repeated "Let them come to Berlin." To the approving screams of the crowd, Kennedy declared "I am a Berliner" in German -- "*Ich bin ein Berliner.*" Some believe, however, that JFK flubbed his German. "Berliner" is also the name of a jelly-filled pastry. According to the myth, Kennedy should have said "*Ich bin Berliner*" and by mistakenly adding the "*ein*," he claimed to be the pastry rather than a metaphorical inhabitant of Berlin. Even some prestigious media outlets have repeated this legend.

For all the faults of John Kennedy, he was not sloppy in his rhetoric. Kennedy jokingly referred to his interpreter (as having to interpret his German) within the text of his speech. The crowd reaction to the key phrase was shouts of joy, not laughter. We will save you the intricacies of German grammar, or any pretense that we know German, but the myth is untrue, akin to assuming that referring to someone as a "New Yorker" means you believe she is a magazine. So why are so many desirous of believing the president made such a gaffe? We believe it is because it makes such a good, ironic story that people want the myth to be true.

***"Men willingly believe
what they wish"***
– Julius Caesar

A similar desire for wish fulfillment is ever present in the investment world. Investors are barraged with, and seemingly accept, statements that make the JFK doughnut legend seem reasonable. "The economy is improving, so stocks will go up," or "The economy is weakening, so stocks will decline," seems to be uttered at least once in every market report. Every month, however, we also get breathless reporting on the government's ten leading economic indicators. Of the ten indicators, the stock market has the best record. The stock market predicts the economy, not the other way around. So why is so much ink and airtime wasted on this false notion of causality?

The news also always seems to include something along the lines of "the market rose today in response to a committee's passage of the budget package in Congress," no matter how implausible the connection between the specific news item and the stock market. When the anchor does a blurb on that day's stock market, after all, he has to say something. To prepare, the staff lists the good and bad news that day. If the market rises, some item of good news is determined to be the cause. If the market declines, the "cause" is taken from the bad news. If the stock market rises and there is only bad news, or the market falls and there is only good news, the market report begins with the word "despite."

When a talking head is touting a particular stock, they tend to refer to good earnings, a new product or some other exciting development as the reason their favorite is about to rise. What is usually ignored, however, is the key question – how much of this supposed impending news is already reflected in the stock price? The stock market tends to be very efficient. At least several professional analysts follow most leading stocks and report anything notable to their clients. Material news moves the stock price up or down almost instantaneously. The market is not always efficient, but you should assume it is unless you have strong evidence to the contrary. If you are investing based upon some news or imminent development, you also need a good reason to believe that you know something the rest of the market players do not. To put it bluntly, what makes you think you are so smart?

Another market myth is the widespread assumption that the recent past will be repeated in the near future – that current market trends will go on indefinitely, and that chasing performance is a winning investing formula. In answer, we enclose our annual listing of the performance of the four major asset classes: large stocks, small stocks, foreign stocks and bonds. The best performer for each of the past 38 years has a box around it. On the right are two mixes of the assets, representing aggressive and balanced diversified portfolios. The data shown are from indexes, so there is no assumed impact from timing or security selection.

***“[What haunts us is] all kinds of old defunct theories, all sorts of old defunct beliefs, and things like that. It’s not that they actually live on in us; they are simply lodged there, and we cannot get rid of them.”
- Henrik Ibsen, Ghosts***

Investing in the balanced mix (with 60 percent in stocks and 40 percent in bonds) has had an average annual total return almost identical to a portfolio 100 percent invested in the S&P 500 index, while experiencing substantially less risk. The performance of U.S. large company stocks in the late

1990’s seems to be lodged in investor memories. This makes it surprising to most people that large stocks have been the best of the four asset classes in only five out of 38 years, much less often than small stocks, bonds or foreign stocks. We believe our chart shows that just about the time you discover a trend, it is about to disappear. Your discovery is already reflected in market prices. You are likely to be a late arrival at the party.

Instead of futilely jumping on the treadmill to try and fulfill your New Year’s resolutions, grab a jelly doughnut and follow our advice. Scorn people trying to use economic forecasts to predict the stock market. Ignore news reports trying to explain the reasons behind daily market movements. Spurn people babbling stock recommendations. Disregard the temptation to invest in something because it is “hot.” If you do, you will save a lot of time that you can spend reading, talking to your children or just relaxing. You will also save a lot of money.

To those who believe there is no rational, disciplined approach to investing, we say *Lass’ sie nach Sigma kommen*. Let them come to Sigma. Our phone number is 503-419-3938 and our website is www.sigmainvestment.com.