

Let's See How Grandma Likes It In the "Big House"

In March 1996, our newsletter *Amateur Hour Déjà Vu* expressed skepticism about three investment novices selling books or advisory services by touting performance that "beat" the market and investment professionals. One of the three, 17 year-old Matt Seto, seems to have virtually disappeared – an Internet search finds only those still selling his book. The Motley Fools, as described last month, have seriously mislead their followers by "forgetting" about underperforming model portfolios and failing to point out that the model they plug as beating the market has actually lost money in the roaring bull market since our newsletter.

***The ham loaf has finally
come home to roost***

The third "guru" we discussed in 1996 was the Beardstown Ladies investment club, a group of elderly women based in a small Illinois town. The club's first book sold 800,000 copies. We noticed the book jacket claimed the club earned 23.4 percent annual returns and were frustrated that the book revealed the Ladies' recipes for ham loaf and angel food cake but didn't reveal the source of the performance number. The club wrote four more books and produced a video. Its members market themselves as speakers and money management consultants. Since the Ladies were cute and provided a heartwarming story, they had massive amounts of print and TV exposure, always with the lead-in that they were trouncing investment professionals. The Ladies provided fodder for the burgeoning financial media, and the media exposure increased sales of the Ladies' "products" in a self-propelling cycle of hype. TV commercials for financial products now regularly feature packs of elderly women, cashing in on the Beardstown Ladies concept.

Well, the ham loaf has finally come home to roost. It was not the credulous financial media that blew the whistle on the Ladies, but Shane Tritsch, writing for *Chicago* magazine. Mr. Tritsch's article, with a subsequent follow-up by *The Wall Street Journal*, led the club to audit its actual investment returns. Instead of earning 23.4 percent per year between 1984 and 1993, the club actually had a 9.1 percent annual return, or only about 39 percent of the hyped, book-selling, media-attracting performance.

To put the club's actual 9.1 percent annual return in perspective, a risk-averse investor in the average government bond mutual fund during the same period would have earned more, about 9.8 percent per year. Somebody who took a little more risk and invested in the average "balanced" mutual fund (with investments divided between stocks and bonds) would have earned 12.6 percent per year. How could they overstate their performance by 157 percent? The

club's treasurer says this was due to a "computer error" in which she applied the club's return for 1991 to 1992 to the entire 10-year reported period.

We saw an interview of one of the "Ladies," who claimed that the club was just expounding on the importance of saving and thrift, not touting returns. Ladies, have you no sense of decency at long last? This group prominently placed the 23.4 percent supposed annual returns on the jacket of a book whose subtitle is "How we beat the market – and how you can too." If the subtitle were "How we earned terrible returns, below even those of government bond funds, during the biggest bull market in U.S. history – and how you can too," how many books would they have sold?

***"How we earned terrible returns during the biggest bull market in US history – and you can too!"
How many books would this sell?"***

Investing has two opposing aspects, reality and the gaming instinct. Reality is putting money aside to achieve life's goals – a comfortable retirement, the education of our children or grandchildren, a legacy in the form of a charitable bequest. A consistent focus on these goals is the secret to successful investing. In contrast, the gaming instinct is trying to beat someone or something – the "market," a brother-in-law, that loudmouth at the office water cooler. This leads to chasing performance rather than focusing on a rational process, and it is why people wind up achieving (according to a study we have described frequently here) only about 40 percent of the returns of the financial instruments in which they invest.

Unfortunately, the gaming instinct is the easiest way to grab someone's attention, so it is the almost invariable focus of the media and ads for financial products. In other words, the bulk of the so-called financial services industry and the people who report on it consistently try to get us to think about our critically important lifetime goals in a destructive way. Every time somebody is talking about investment performance (rather than investor behavior) or uses the word "beat" in relation to any financial product or service, hold onto your money.

Of course, our first thought when "Beardstown-gate" broke was what would happen to us if we overstated our performance by 157 percent, reaped huge financial rewards from the mistake, and then attributed the mistake to a computer error. We would be trying to figure out how to add a metal file to the ingredients in that angel food cake recipe to get it past the prison guards. Not that we are inclined to spend taxpayer money to prosecute club members – they would probably just wind up at one of those country-club prisons where everyone plays shuffleboard.

Rather than being distracted by recipe-swapping clubs, "Fools" or 17 year-old gurus, you should trust your future to a diversified, rational, long-term investment program. Contact us.