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Amateur Hour Deja Vu

When I started investing in the late 1960's, near the end of an extended bull market, bookstores were full of stock market guides authored by people who were not investment professionals. The message of these books generally amounted to "I'm an idiot, I made a million, and so can you!" The first stock market book I ever read, subtly titled *How I Made \$2,000,000 In the Stock Market*, was written by Nicolas Darvas, a professional dancer. I was overcome by nostalgia during a recent visit to the local bookstore. The three most prominently displayed business books were written by investment amateurs bubbling over with excitement about how easy it is to make money in the stock market.

Matt Seto, all of 17 years old, wrote *The Whiz Kid of Wall Street's Investment Guide*. Based on his performance claims, Mr. Seto will own most of the world before too long, so perhaps it is unwise of me to criticize him in print. My perusal of the book, however, leads me to believe it is virtually contentless. Mr. Seto displays an unexpected modesty in not substantiating his claimed 34 percent annual performance when asked to do so by the media. Seto has made some fairly bad public predictions, reminding me of Churchill's description of "a humble man, with much to be humble about."

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An investment club of elderly women has written *The Beardstown Ladies Common Sense Investment Guide*. The Beardstown Ladies primarily rely upon the Value Line Investment Survey and their book cover touts 23 percent annual returns. Value

Line runs mutual funds based on its own system that have not done nearly so well. How the Beardstown Ladies could beat Value Line is a mystery. Unfortunately, it will remain a mystery -- while the Ladies disclose their recipes for ham loaf and angel food cake, they refuse to disclose what is behind their claimed performance.

The Motley Fool Investment Guide by David and Tom Gardner recommends investing the core of your portfolio in the second through fifth highest-yielding stocks from among the 30 stocks in the Dow Jones Industrial Average. This is a variant on the "Dogs of the Dow," a well publicized stock selection method. The theory of buying beaten up, out-of-favor stocks has some merit. Virtually every financial magazine has done a recent article on the Dow Dogs. The method was developed by analyzing historical performance. Now that the theory is developed and publicized, legions of investors bidding up the Dogs of the Dow will tend to destroy the method's effectiveness. The stock market is competitive enough that if everyone knows something, it probably won't translate into superior returns.

Our main problem with the Motley Fools is their claim that following their methods will result in 30 percent annual returns. Since not even the Dogs of the Dow theory, with its perfect 20-20 hindsight, has remotely approached 30 percent annual returns, the Fools spice up their portfolios with speculative high technology stocks. The Fools have been in business only since August 1994, and their undiversified, technology-laden portfolios have had outstanding performance in the buoyant market since then. Extrapolating a 21 month record far into the future, however, is silly. As we discussed last month, 30 percent annual returns are so far out of the realm of historical experience that the Fools' claims may create dangerous, unrealistic expectations. Out of the more than 7,000 mutual funds in our database, not one has even achieved a 21 percent compounded return over the past 15 years. The Motley Fools would point out that the funds in our database are managed by investment professionals, whom they sarcastically refer to as "the Wise." The Fools believe that knowing too much hinders your performance. It's enough to make me long for those halcyon days when being smart was, as Martha Stewart says, "a good thing."

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The Fools have also created electronic mail message boards on their recommendations, including Iomega Corporation, a computer drive manufacturer that has had a tremendous

surge in the stock market this year. People posting messages refer to themselves as "Iomegans," which sounds vaguely like a Federation enemy in a Star Trek episode. A stock market truism is that "the stock doesn't know you own it." When people refer to themselves as Iomegans, there appears to be an attachment to a stock that could prove to be unhealthy in a financial, if not an emotional, sense. (Recognizing this apparent need to belong, however, we have given some thought to starting a group of "Sigmaniacs.")

While there is some good information in these books, it appears the authors are attempting to increase sales by claiming gains that are not within the realm of possibility. Buying the book promising the highest return just means you will be paying a royalty to the most unrealistic author. Your time, not to mention your money, is better spent developing a realistic long term strategy for your investments.

-- William A. Berg