



May 1999

All I Really Need to Know About Investing I Learned in High School

For most of us, high school was a time of pretense -- behaving as if we knew more than we knew, acting "cooler" than we were, and simulating more sophistication than we possessed. Feigning expertise in sex, drugs and rock and roll, among other topics, was of paramount importance. The teen years began a long period, continuing through today for most of us, in which it is very hard to ever say "I don't know."

If we are lucky, the getting of wisdom begins in middle age, when we finally are able to admit to ourselves that we are never going to learn to speak Russian, become a scratch golfer, play the saxophone or run a marathon. Many who would shudder to remember the pretensions of their high school years, however, find it difficult to acknowledge that they are not investment experts. After years of stock market gains, the talk around the water cooler, clubhouse locker room or cocktail party seems invariably to turn to the investment coups of some self-styled Peter Lynch or Warren Buffett, leaving everyone within earshot feeling inadequate.

If we are lucky, we start to admit to ourselves in middle age that we are never going to play scratch golf or run a marathon.

Of course, this type of bragging has been around for a long time, but it is worse now. First, though someone may impress you with a system for winning at the roulette wheel, it does not matter if you are unlikely to hit the gambling circuit. On the other hand, the fates have recently conspired to end traditional pensions and diminish Social Security, leaving you in charge of your retirement wealth and income. Investing is a matter you must address one way or another. Second, the bull market is on the news every night, thrusting a procession of announcements of record highs into the public mind. As luck would have it, the best investment over the last four years (large company U.S. stocks) is also the one most widely reported.

Finally, the bragging has recently gotten worse because of the trajectory of Internet stocks. Tales of vast wealth quickly made have given many the idea that everyone is getting rich except them -- the train is leaving the station and they had better jump on while they have the chance. The result is a gold rush effect in which normally sane people, many of whom would scoff at the idea of buying a lottery ticket, thoughtlessly fling years of hard-earned savings into the stocks of untested companies. Even worse, they may quit their jobs and become day traders. As pretensions go, logging-on in the morning and expecting to out-trade Salomon Brothers ranks right up there with your high school friend who tried to get dates by claiming to be a CIA operative. And as you would know if you hadn't skipped history class to posture in front of your locker, gold rushes tend to end ugly.

We do not suggest that adolescent pretense is limited only to novice investors. On the contrary, the more one is expected to know about the markets, the more likely one acts as if guided by a crystal ball. The lemming-like behavior of stock market analysts would put any group of high-schoolers to shame. After all, analysts and pundits are human too, or at least nearly so.

Thinking you're going to beat Salomon Brothers at trading ranks right up there with your friend pretending to be a CIA operative to get a date.

For example, many investment experts, trying to get you to believe they saw it coming, explain recent large company stock dominance by claiming these companies are better positioned for the "global economy." The large company stocks in the S&P 500 index had a total return of 75 percent in the two years ended March 31, despite falling earnings. The gain wasn't based on the reality of earnings, just how we *felt* about that reality. In the same period, the small company stocks in the Russell 2000 returned less than 19 percent, but their earnings grew more than 18 percent per year. Shouldn't the large company stocks be demonstrating their "better positioning" by actually growing earnings more than the small companies? Just pretending doesn't make it so.

Ultimately, your retirement will be like your last school graduation. Pretense will suddenly be overshadowed by reality. Tales of stock market coups will matter less than how much is in your account, how you can avoid losing it, and what return it will generate. The stakes involved -- your retirement lifestyle and, quite literally, your legacy -- are much greater than being embarrassed at a party or not getting to hang with the cool kids. There is no shame in asking for help in developing a rational, long term investment plan. It is not an admission of ignorance, but of the victory of having enough money to worry about and the intelligence to invest it wisely.

Follow-up to our 10,000 Maniacs newsletter. Ned Davis Research tells us that after the Dow Jones Industrial Average first crossed 100 in 1906, five of the next six bull markets peaked within 10 percent of that level over the subsequent 20 years. After the Dow first crossed 1,000 in 1966, the next seven bull markets peaked within 10 percent of that level over the next 20 years. We are not predicting a 20 year ceiling on stock prices just because we've exceeded 10,000 on the Dow. History shows, however, that passing a "magic" level doesn't mean only bull markets lie ahead.

If you want to develop a rational investment plan that forgoes teenage pretense, locker room chatter and gold rush mentality, not to mention numerology, contact us.