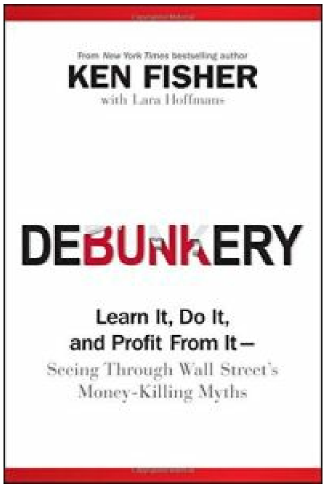

Book Debunkery

Learn It, Do It, and Profit From it — Seeing Through Wall Street's Money-Killing Myths

Ken Fisher and Lara Hoffmans
Wiley, 2010

Recommendation

Investment expert Ken Fisher understands what drives the financial markets, and he uses his knowledge and experience to debunk 50 widely held investment myths. Writing in a crisp, straightforward style, Fisher, collaborating with business writer Lara Hoffmans, presents research data that correct much of the investing public's conventional – but flawed – wisdom. In the process, he explains what shapes markets at the macro and micro levels, and he applies principles of "behavioral finance" to show why people cling to popular but disproven market lore. The result is advice anyone can use to manage any portfolio. While the 50-myths format may be somewhat gimmicky, it's fun and *BooksInShort* thinks the book offers valuable information for investors of all experience levels. Realizing your investing weaknesses on its pages is both cheaper and easier than making expensive mistakes in the market.

Take-Aways

- Many financial myths steer investors in the wrong direction. Study the facts:
- Investing is about probability; even great investors are right only around 70% of the time.
- Over the long term, shares are less risky and more profitable than bonds.
- Investors with 20-year or longer time frames must increase their equity exposures, especially 65-year-olds, who have a median life expectancy of 85.
- Investors' average holding period for equity mutual funds is 3.2 years.
- Beta, a measure of risk, tracks only past volatility and has no predictive capabilities.
- A variable annuity carries high fees and commissions and is only as good as the insurance company that issues it.
- An American president's political affiliation isn't statistically responsible for either bull or bear markets.
- The US accounts for less than half the world's market capitalization, so invest 50% of your equity allocation in non-US firms.
- In the aftermath of several global terrorist attacks, stocks fell short-term but then recovered and resumed their near-term trends.

Summary

The Power of Myth

Investors often forget that investing is about probability. Your goal is to be right more than you are wrong. Even the greatest market gurus are right only about 70% of the time. If you can improve your odds, you'll be ahead in the investing game.

Investors of all stripes – even professionals and experienced individuals – often commit the same mistakes over and over, in part because they don't grasp market psychology. Most people follow a herd mentality, or they fall prey to long-held prejudices, false doctrines and bad information. Or they stick with a winning strategy that eventually loses. To break this syndrome, learn to question common investment wisdom, adopt a scientific approach and recognize that you're still likely to make mistakes. Accept that unprofitable deals are an inherent part of the investment process. Be aware of 50 commonly held myths about the capital markets, and the facts that debunk them:

1. **"Bonds are safer than stocks"** – Over time, stocks produce less-risky, more-positive returns than Treasury bonds. When inflation hits, bond prices fall, and bondholders eventually get repaid in inflation-reduced dollars.

2. **“Well-rested investors are better investors”** – Because they consider shares too risky, investors who like to sleep through the night typically shun stocks. Yet research shows that in the course of 20-year rolling periods stocks beat bonds 97% of the time. So learn to tolerate some volatility to profit from higher potential returns.
3. **“Retirees must be conservative”** – A 65-year-old today has to fund an estimated life span of 85, so older investors should raise their equity exposures to realize greater returns (compared to those of bonds) and to outpace inflation.
4. **“Age equals asset allocation”** – This simple formula says that investors should subtract their age from 100 to get their recommended equity allocation. But, while age may be a factor, individuals vary. Investors should consider their health, life expectancy, portfolio growth goals and cash flow needs.
5. **“You should expect average returns”** – Most investors take the “simple average” equity return of 11.7% since 1926 as the norm, but, statistically, it’s occurred only one-third of that time. Higher-than-average returns have happened 38% of the time, while results were negative for almost 29% of that period.
6. **“‘Capital preservation and growth’ is possible”** – You can’t achieve real growth in your portfolio without taking some risk with your capital. Include equities to protect your purchasing power in the event of inflation.
7. **“Trust your gut”** – Behavioral research shows that US investors fear losses 2.5 times more than they enjoy gains. So don’t sell in a panic; fight your primal instincts, and control the short-term fear that can produce long-term losses.
8. **“One big bear and you’re done”** – Investors who suffer through bear markets think they have to revert to bonds and cash to avoid declines. But bull markets follow bear markets: Over time, stock market surges will compensate for bear market losses.
9. **“Make sure it’s a bull before diving in”** – Timing the market for its lows is nearly impossible, so bear market veterans mistakenly wait for definitive signs that the market has turned. Big mistake: Bull markets power up fast, and you’ll likely miss out if you hesitate.
10. **One investment style or sector is always the best** – Market change is constant and unpredictable, so strictly adhering to only one investment style, such as small-company shares, growth stocks or value stocks, inevitably produces losses.
11. **“A good con artist is hard to spot”** – Bernie Madoff fooled hundreds of investors, yet he displayed the five warnings you should know: 1) He kept client assets under his control, 2) his results were “too good to be true,” 3) he never disclosed how he made those great returns, 4) he touted his exclusivity and 5) his clients blindly trusted their friends’ referrals.
12. **“Stop-losses stop losses”** – Automatic sell orders may seem attractive, but they can cut your earnings. Just because a share drops below your set price doesn’t mean it will continue to fall. Traders who use stop-losses pay higher fees and miss stock rebounds.
13. **“Covered calls…gotcha covered”** – Options like covered calls seem like a good idea, but they can prevent you from realizing all the upside potential of a rising stock.
14. **Dollar cost averaging (DCA) is always a good idea** – Brokers say you should invest smaller amounts periodically rather than a large sum of money all at once. But DCA ups your commission costs, which reduce returns but don’t reduce risk. Lump-sum investing results in higher returns 69% of the time.
15. **Variable annuities (VAs) are a sure thing** – Guaranteed income sounds great, but VAs charge huge commissions, up to 14% of your assets. Your VA is only as good as the insurance firm that issues it; you could lose your entire nest egg if the insurer fails.
16. **Equity-indexed annuities are even better** – These annuities typically come with capped return rates, and the fees and fine print associated with them greatly diminish their purported benefits.
17. **“Passive investing is easy”** – Investing in line with a market index can be profitable, but only if you resist the urge to trade in and out of your positions. Not many people can: The average equity-fund holding period is only 3.2 years.
18. **No-load mutual funds are cheap** – Investors who buy no-loads (funds without a sales commission) may save on fees, but they can incur other costs by frequently “switching” or trading among funds. A 5% sales fee on a fund might keep you from selling it too quickly.
19. **“Beta measures risk”** – Though academics and market professionals widely cite it, beta only measures past volatility; the metric has no predictive capabilities. In bear market recoveries, high beta stocks bounce back faster than lower beta shares.
20. **Equity risk premiums (ERPs) are good predictors** – ERPs measure how much more you earn from stocks than from low-risk Treasurys. But ERPs are not reliable in the long term since no one can predict the future supply and demand for stocks.
21. **Buy when volatility is high** – The Chicago Board Options Exchange Volatility Index (VIX) indicates how risky the equity market might be in the course of a 30-day period. But this short-term “fear index” has no predictive value for individual stocks, nor can it identify peaks and troughs.
22. **“Be confident on consumer confidence”** – Consumers’ feelings are a lagging, not a leading, indicator of stock market advances. People react to market moves, which affect their moods.
23. **“All hail the mighty Dow!”** – The Dow Jones Industrial Average is a flawed, narrow (just 30 stocks), price-weighted index that misreads real economic activity.
24. **“So goes January”** – Some believe that price moves in January augur the market’s direction for the entire year. But January’s moves hold no such predictive power.
25. **“Sell in May”** – Trading by the calendar is arbitrary and statistically invalid. Days, months and seasons don’t sway the market; complex, changing human and environmental factors do.
26. **“Low P/Es mean low risk”** – Price-to-earnings ratios are useful as relative measures but worthless as future market predictors.
27. **“A strong dollar is super”** – Sturdy or frail, the dollar has no bearing on changes in the American and world stock markets.
28. **“Don’t fight the Fed”** – Popular wisdom has it that interest rate hikes are bad for stocks, and vice versa. But from 2001 to 2003, the stock market floundered as the Fed continued to cut rates.
29. **“Interest pays dividends”** – Retirees think they need to keep their investments to gain the income they provide. But you can generate cash flow by selling stocks tactically and buying dividend-paying shares.
30. **Just buy safe CDs in retirement** – Even average rates of inflation can eliminate over half the purchasing power of your certificates of deposit during a 20-year time frame.
31. **“Baby boomers retire, world ends”** – Stock markets aren’t in imminent danger. Aging boomers will keep investing to fund retirement, and global markets can more than adequately absorb any age-related demographic changes.
32. **“Concentrate to build wealth”** – Owning more than 5% of your employer’s stock in your retirement savings is a mistake. Diversification helps to protect your capital.
33. **“Pray for budget surpluses”** – Since the late 1940s, US government budget surpluses have correlated with bear markets, while budget deficits track bull markets. A government with a surplus will cut its spending, thus signaling a potential economic slowdown to markets.
34. **“High unemployment is a killer”** – A recovering jobs rate lags a recovering economy. Spikes in productivity during periods of high unemployment mean firms get by without hiring new staff for longer than ever before.

35. **“With gold, you’re golden”** – Since 1973, gold has underperformed both the S&P 500 and 10-year Treasurys on an annualized return basis. From 1982 to 2005, gold dropped in value.
36. **“Stocks love lower taxes”** – Historical data show no connection among tax rate shifts, stock returns or market directions. Moreover, proposed reduced capital gains taxes, which could motivate investors to sell, may roil markets and, perversely, bring them lower.
37. **“Oil and stocks seesaw”** – Many investors believe higher oil prices mean lower stock prices. Yet, surprisingly, correlations between the two since 1980 are statistically “meaningless.” The two asset classes may show a relationship in the short term, particularly for energy companies.
38. **Epidemics have an impact on markets** – Swine flu, SARS and AIDS are global diseases with devastating impact, but they don’t affect markets. In 1918, roughly a third of the Earth’s population suffered the deadly Spanish flu, but shares rose 26% that year and 21% in 1919.
39. **“Consumers are king”** – While consumer spending accounts for 71% of the US’s gross domestic product (GDP), individuals don’t significantly cut their expenditures during recessions. Declines in “business investment and net exports” drag the economy down more than consumers do.
40. **“Presidential term cycles are stock market voodoo”** – The first two years of a US president’s term stress markets more than the next two because the incumbent pushes partisan legislation, and the resulting “political risk aversion” dampens returns.
41. **“My political party is best for stocks”** – A US president’s political affiliation isn’t statistically responsible for either bull or bear markets. Election-year returns are above average when Republicans take over from Democrats, and below average in the reverse. Yet markets reverse in the first year of a commander-in-chief’s term.
42. **“Stock returns are too high and must fall”** – Investors are afraid of heights, and those fears compound when statisticians plot data on different scales. Linear scaling expresses long-term price moves dramatically, but logarithmic scales use percentage price changes, which make for less vertiginous chart climbs.
43. **“Foreign stocks feel so…foreign”** – The US accounts for less than half the world’s market capitalization, so invest 50% of your equity allocation in non-US firms.
44. **“Who needs foreign?”** – Though correlated, US and global stock markets present opportunities at different times. Owning both types produces a reliable income flow.
45. **“Big debt is national death”** – US net public debt reached 53% of GDP in late 2009, but this isn’t much more than it was during the 1990s, when the stock market and economy posted solid returns.
46. **“America can’t handle its debt”** – US net interest debt payments are a scant 2.2% of GDP, “perfectly unremarkable compared to past periods.” From 1984 to 1996, interest payments relative to GDP were twice what they are today, and the US economy prospered.
47. **“Indebted to China”** – China owns 7.3% of US debt; Japan, 6.2%. American interests such as Social Security, states, federal agencies and US investors hold 70%. If China were to sell, the price drop and yield increase would entice others to buy.
48. **“Trade deficits make deficient markets”** – Even with the world’s biggest trade deficit at the end of 2009, the US deficit still accounted for only 3.5% of its $14 trillion economy. Countries such as Germany and Japan, which have ongoing surpluses, have faced lower GDP growth and returns.
49. **“GDP makes stocks grow”** – The stock market reflects the future prospects of the economy, up or down, but GDP is a measure of past economic activity.
50. **“Terrorism terrorizes stocks”** – After the Sept. 11, 2001, attacks, stock prices fell by almost 12%, but by Oct. 11, shares regained all their losses. Assaults lead to short-term drops in stocks, but they recover. Capitalism always wins.

About the Authors

Ken Fisher writes the “Portfolio Strategy” column for *Forbes* magazine. He is the founder and CEO of Fisher Investments, where **Lara Hoffmans** is a content manager.