

Chapter 9

The Persuasive Power of the Printing Press

News is that which will create greatest excitement among the greatest number.

Ayn Rand - Fountainhead

Interviewing for *Barron's*, journalist Gene Epstein asked University of Chicago economist and Noble Prize Laureate Merton Miller what advice he would give the average investor.

Miller gave Epstein a surprising answer:

“What advice would you give the average investor?”

“Don't quote me on this, but I'd say don't read *Barron's*.”

“Why!?”

“Because it will only tease you about investment opportunities you'd best avoid.”

Hat's off to *Barron's* for printing Miller's honest answer¹.

How good are investment selections found in newspapers, magazines, books, investment newsletters, and the Internet? They may be entertaining and informative, but according to several independent studies, they offer little value to investors seeking superior performance. In fact, most investment recommendations in the financial press lead to below average returns. This chapter reviews the quality of investment information found in the printed media, and explains how that information widens the gap between investor returns and market returns.

Newsletters

Investment newsletters are as popular as supermarket tabloids, and most are about as honest. Newsletters are purchased on a subscription directly from the writer. Some newsletters sell annual subscriptions for a couple of hundred dollars, and others demand thousands of dollars. How good is the advice in newsletters? As we will soon learn, it is not good at all. However,

¹ Gene Epstein, *Prizing Caution*, *Barron's*, June 2, 1997, pg. 28

newsletter writers would never admit to consistently poor performance, nor do they have to. The Security and Exchange Commission does not govern the media, which is what a newsletter is. Instead, written content in a newsletter falls under the First Amendment and Freedom of the Press. As a result, newsletters, newspapers, magazines, etc. do not have to report the performance of their investment recommendations. If they do happen to publish a return, it does not have to be checked by a CPA firm, so it is often inaccurate and exaggerated.

You may think that newsletter writers should be held responsible for their recommendations, but that is not the case. In 1985, The US Supreme Court ruled that investment newsletters were journalistic articles, not investment advice. Therefore they are exempt from the Investment Advisors Act of 1940 and not subject to SEC regulation. This means newsletter writers can claim they achieved any performance they wish, even if it is not true, and their claim is protected under the First Amendment.

A perfect example of this is *California Technology Stock Letter*, published by Michael Murphy. In a recent advertisement for this newsletter Murphy claimed incredible stock-picking ability, routinely touting stocks that had 700% to 900% returns. Unfortunately, Murphy must not be taking his own advice. The *Monterey Murphy New World Technology Fund*, personally managed by Mr. Murphy, was the worst performing technology fund in the country over a three-year period ending in 1998. The performance of this highflying wonder was negative 8.3%% annualized, compared with a 27.6% annual gain during the same period for the average tech-fund fund².

Michael Murphy is not alone. In late 1987, a self-proclaimed market guru named Joe Granville predicted the market would crash, and he became famous when it did. While Granville was correct on that occasion, he has been wrong ever since. Although Granville claims high returns in his newsletters, for an 18-year period ending in 1998, *The Granville Market Letter* lost 22.5%. Despite this dismal record, the media still seeks his insight, and he is hailed as an important market expert.

As a group, newsletter writers have a terrible track record of picking stocks and mutual funds. The *Hulbert Financial Digest* has been tracking the performance of investment newsletters since 1980. During that period, founder Mark Hulbert isolated only

two newsletters that have beaten the Wilshire 5000, a measure of the broad US stock market³. Since most letters engaged in some sort of market timing, the average letter had only 54% invested in equities during the period. That lowers performance during a bull market for stocks, which explains some of the poor performance. Regardless of that fact, almost every “stock only” letter failed to keep pace with the general market average.

One newsletter that did perform well in Hulbert’s study was the *Value Line Investment Survey*. Each week Value Line evaluates 1,700 stocks and awards 100 of them their top “timeliness” rating. According to Value Line, a portfolio of these top 100 stocks would have beaten the market since the early 1980s. Unfortunately, the *Value Line Fund*, which is managed using the timeliness rankings, had no such luck. The *Value Line Fund* returned 2% less than the market over the same period of time. This is very ironic. In advertisements, Value Line insists the system works, but in practice, it does not work in their own mutual fund. The difference between the real world returns of the fund and the theoretical returns of the strategy are explained in part by trading costs and human judgement. The real world weakness that applies to Value Line data applies to other strategies as well. It is always possible to beat the market in theory, but it is much harder in practice due to fees, expenses, and operational inefficiencies.

Magazines

Wall Street is a place where people who ride a limo to work get their investment advice from people who ride the subway.

Warren Buffet

Finance related magazines have become one of the most influential sources of investment information for do-it-yourself investors. These publications have grown in both circulation and ambition. By ambition, I mean that over the years there has also been a major editorial change. Prior to 1990, financial magazine articles were generally aimed at helping readers cope with financial planning issues, as well as helping them understand the workings of the markets. In recent years, the publications have focused efforts on providing readers with

² Karen Damato, *A Tech Expert’s Own Fund Takes Worst Place*, *Wall Street Journal*, 2/26/99, c1

³ Mark Hulbert, *Newsletters vs. Funds: Which are the Better Performers?*, *AII Journal*, September 1998

detailed investment advice, specifically individual stocks and mutual funds. While this may have lead to wider readership, it has not resulted in higher returns for readers, as the following paragraphs attest.

Money Magazine Study

Money magazine has recommended specific stocks since the early 1980's. Many of these recommendations occur in the annual *Forecast* issue published in late December. In this special issue, Money attempts to make sweeping forecasts about the markets and it highlights stocks the editors think offer superior potential in the coming year. Money editors also made specific sell recommendations in most Forecast issues.

Since Money is a favorite magazine of do-it-yourself investors, the major advertisers tend to be no-load mutual fund companies and discount brokerage firms. Full service brokerage firms like Merrill Lynch and Salomon Smith Barney traditionally were not big advertisers in Money, and as a result the editors of that magazine have no remorse about smearing brokerage firms in favor of larger mutual fund clients. In 1995, Smith Barney grew tired of Money's name calling, and used the annual Forecast issue to show how poor the magazine's editors were at selecting stocks.

Performance Results of Stock in *Money Magazine's Annual Forecast Issue*

	1990	1991	1992	1993	1994	Annual	Cumulative
Buy Recommendations	-16.7%	38.3%	-13.1%	-5.8%	2.1%	-0.8%	-3.7%
Sell Recommendations	-23.1%	23.4%	83.6%	12.0%	NA*	18.2%	95.1%
S&P 500	-3.2%	30.6%	7.7%	10.0%	1.3%	8.7%	51.7%

Data Source: Salomon Smith Barney *Money did not make sell recommendations in 1994.

During the five-year period, Money's buy recommendations fell far below the stock market. In fact, the cumulative buy recommendations lost -3.7% over the period while the S&P 500 gained 51.7%. More interesting was Money's sell recommendations. If you bought the stocks that Money advised you to sell, you would have beaten the stock market by a whopping 43% percent!

Forbe's Honor Roll

Many investors rely on published rankings to select their mutual funds. Each year Forbes magazine publishes an "Honor Roll" of mutual funds, highlighting those the editors believe will provide steady, long-term performance in both bull and bear markets. Forbes claims these funds have "consistency of performance and toughness in tough times".⁴

Princeton University professor Burton Malkeil, author of the widely acclaimed investment book, *A Random Walk Down Wall Street*, [W.W. Norton, NY] questioned the Forbes ability to choose mutual funds that achieve superior returns. Malkeil conducted an independent study of the Honor Roll funds and found that they resulted in returns below the market⁵.

For the entire 1975 to 1990 period, the Honor Roll funds performed 1.4% less than the S&P 500. However, in the later years, the funds were significantly below average. From 1983 to 1990 the Honor Roll Funds returned 6% below the market, and the group did not beat the market in any year. Other studies of the Forbes Honor Roll support Malkeil's conclusion.

Gauging the Market with Magazine Covers

Let's imagine for a moment that you have been on an extended trip to a remote region of the world. For three years you have had been completely cut off from business news and have no idea what happened in the stock market. Upon your arrival back in the US, you notice one popular business magazine cover reads, "Market Collapse May Send Economy Into Tailspin", and a second glows one word "Armageddon?"

Uh-oh. Before leaving you had put your entire retirement account into a stock mutual fund. Are you wiped out? Not quite. A quick call to your mutual fund company reveals that the value of your account has doubled over the last three years. How could that be? You wonder what market the magazines are talking about.

Magazine covers convey how we all feel about the markets today, not what happens over the long run or what will even happen in the near future. If stocks ran up recently, magazines print pictures of bulls and dollar bills. If stocks go down, bears and havoc cover

⁴ *Forbes*, August 29, 1994, pg. 132

⁵ Burton G. Malkiel, *A Random Walk Down Wall Street*, W.W. Norton & Co. NY, 1996, pg. 444

the newsstand. In 1991, Ned Davis elaborated on this subject in his colorful book, *Being Right or Making Money*.⁶ He reviewed magazine covers before and after major turning points in the markets. Davis found the covers are a good way to determine when crowd psychology is at an extreme. When a large number of covers are bullish or bearish, investors should wait 30 days and then beat against the trend. Davis says this method proved to be an accurate indicator nearly 80% of the time. While I do not advocate trying to time the market using magazine covers, it is interesting to look at some examples in the book:

On January 1, 1973, *Barron's* headlines read "Not a Bear Among Them", referring to the panel of investment experts on Barron's Roundtable. The article said the panel was "bullish on Wall Street, business, and the markets." Over the next 30 days, the worst bear market since 1929 began. In 1973 and 1974 the S&P 500 fell over 40% and small stocks fell over 80%.

August 1979, after six years of poor stock market performance, *BusinessWeek* announced "The Death of Equities" on their cover. They advised readers to sell stocks and invest in bonds linked to the price of gold and oil. That issue marked the beginning of a major rally on Wall Street and the peak in gold and oil prices.

In early October 1987, *Fortune* magazine printed a cover story titled, "Why Greenspan is Bullish". The story praised the US economy as well as the stock market. Two weeks later the October '87 crash occurred and stocks lost 20% in one day.

In the mad scramble for readers' attention, editors sensationalize current investment sentiment hoping to capitalize on fear or greed. When the market has been good, magazines print the market will get even better. When the market has been bad, they print it will get worse. The truth is, magazine publishers are not in the business of making readers rich by correctly predicting the market. Their job is to sell advertising space, and fear and greed stories significantly increase readership. Magazine editors do not care what their track record is on market predictions. It is irrelevant to their real job.

Newspapers

⁶ Ned Davis, *Being Right or Making Money*, published by the author, fourth printing 1995, pg. 39

Most newspapers publish stock and bond prices on a daily basis. When the stock market makes a large move one way or the other, journalists try to find the reason why. Many get their information from the national wires, or phone local experts for a quote. As a result, the reason the stock market went up or down is different depending on which paper you read. For example, the reason the market fell as published in the *Boston Globe* may differ from the *Chicago Sun*, which may differ again from the *Los Angeles Times*. It's really up to the reporter covering the story, and the opinion of the local experts they interview.

Newspapers and Their Advertising Clients

The typical investment company spends a lot of money placing advertisements in newspapers across the country. Therefore, when an expert opinion on the markets is needed, journalists are likely to call advertising clients for their thoughts. Some of those comments are then placed into a news story, which is free marketing for the investment company. Though much of this name-dropping in a story is subtle, there have been obvious attempts by major newspapers to steer readers toward investment companies that purchase sizable ad space.

On December 31, 1996, the *Investors Business Daily (IBD)* newspaper ran a front-page article about investment opportunities in sector funds. The story was titled "Playing Hot Sectors with Mutual Funds". The story mentioned Fidelity sector funds five times in the article, but there was only a hint of other companies offering competing funds. While a story mentioning Fidelity funds is not out of the ordinary, the full-page ad for Fidelity Select funds printed on page three was quite a coincidence. In rereading the article, it became clear that the story was planted by IBD in conjunction with the Fidelity placing the large ad.

On August 4, 1998, technical analyst Ralph Acampora from Prudential Securities made a bearish call on the stock market. He made this announcement on national TV about 2:00 PM in the afternoon, after the market had fallen substantially earlier in the day. The following morning, *USA Today* carried a lead story about the sell-off, highlighting Acampora's comments, and featuring a picture of him on the front page of the business section. Acampora was credited with calling the decline, even though he talked about it on television after the market was already down. Nevertheless, Ralph Acampora became *USA Today's* master of the stock market.

The whole setup of the story struck me as strange. Why all the attention on Ralph Acampora? About half way through the sports section of that newspaper I got my answer. On page C12 there was a full-page ad for Prudential Securities. The caption read, “When Your Goal is Capital Preservation, Call Prudential”. Now everything made sense. In exchange for hyping Acampora, Prudential bought a full-page ad in the newspaper. It was a well-planned media extravaganza.

Ralph Acampora’s guess was wrong this time. Within a year, the Dow Jones Industrial Average was up over 40%. It even surged through 10,000 for the first time in history. *USA Today* did not print that story.

Stock Picks in Newspapers

Newspapers are not held accountable for their investment recommendations, nor do they keep track of the stock picks. *USA Today* frequently selects stocks for their “Market Highlights” section. These stocks are based on analyst recommendations from various brokerage firms that advertise in that newspaper.

M. Mark Walker and Gay B. Hatfield of the University of Mississippi evaluated the performance of these *USA Today*’s stock picks to see if investors could achieve above average returns by following them⁷. The study covered a period from 1988 to 1990, and looked at 329 stock recommendations. Walker and Gay found that the stocks highlighted in *USA Today* only lead to superior returns if an investor knew the stocks the day before the newspaper was published. If investors bought the stocks after the paper was published, they would have realized below market returns. Of course, acting on inside information is illegal, so no one can buy the stocks before the paper is published. The moral of the story is that the newspapers do not provide investment information that the average person can use to make superior decisions.

Hypothetical Strategies Verses Real Returns

⁷ M. Mark Walker and Gay B. Hatfield, “Professional Stock Recommendations: Implications for Individual Investors”, *Financial Services Review*, vol. 5, no. 1 (1996), pg. 13-29

William O'Neil is a big name in investment research. The William O'Neil Company publishes *Investors Business Daily* and offers a wide assortment of investment publications. O'Neil also runs seminars based on his proprietary C-A-N-S-L-I-M method of stock selection. His technique is based on years of studying past market winners. The O'Neil method is well researched and theoretically accurate. However, it fails to produce superior returns when actual money is applied to the theory.

In the mid-1980s, David Ryan became famous by winning a stock-picking contest run by Stanford University. His track record over three years was an incredible 1,397%, on paper. Unfortunately for Ryan this was only a theoretical gain. Actual money was not used in the contest⁸. The press from the contest landed Ryan a job at O'Neil's company, and in 1993, Ryan became the portfolio manager of O'Neil's *New USA Growth Fund*. The fund used the patented C-A-N-S-L-I-M method of stock selection as well as Ryan's stock picking experience. Over the next three years, Ryan's performance never came close to the theoretical results of the Stamford contest. Management expenses were too high and portfolio turnover averaged 500% per year, which resulted in large trading costs. In early 1997, the *New USA Growth* fund was sold to another mutual fund company and the remaining assets were merged into a larger mutual fund at that firm.

The *New USA Growth Funds* is an example of how difficult it is to take a strategy that works on paper and make it work with real money. The proliferation of investment software and availability of detailed financial information make it easy for anyone with computer to develop simulated investment strategies that would have worked well. However, there is no guarantee the strategy will work well in the future. Switching from a classroom experiment to managing real money changes the nature of the markets so that no model can accurately predict the outcome. As a result, actual returns are never the same as the expected returns, regardless of the time and effort put into the computer model.

Books

Investment books can be categorized into three broad types. The first type of book is written by academics for students and can be found on college bookshelves. The second type is

⁸ Jack D. Schwager, *Market Wizards*, HarperBusiness, 1989, pg. 238

written for the general reader who is interested in improving their investment skill. The third type is written for the purpose of making the author rich at the expense of the reader.

Books for General Reading

Many titles for general reading have wide reader acceptance like “Bogle on Mutual Funds” by John Bogle, Chairman of the Vanguard Group, and “Investment Biker” by Jim Rogers. These books are written for a wide audience, attempting to capture the interest of professional and non-professional investors. Experienced money managers like Bogle and Rogers make excellent reading. The authors are original, honest, and have something genuine to say. There are times when money managers can go a little overboard. Peter Lynch, former manager of the *Fidelity Magellan* fund, wrote three books on beating the stock market. While Lynch’s books were interesting, they did little to improve the results of the average reader because the average person does not have the resources Fidelity has.

Some books for general reading include those written by journalist. Typically, these works are well researched and very informative. *Fidelity’s World*, by Diana B. Henriques, offers a behind the scenes look at the mutual fund business. *Buffett: The Making of an American Capitalist*, by Roger Lowenstein, is an excellent journalistic work about the life of Warren Buffett. *The Confidence Game*, by Steven Solomon, explains in detail the thinking of Federal Reserve Chairman Greenspan. These books offer wonderful insight into special topics within the financial services industry.

Make-Me-Rich Books

Unfortunately, many books are published for the purpose of making the author and publisher rich at the expense of the reader. These are better known as get-rich-quick books. Here you will find every marketing gimmick imaginable. There is heavenly advice found in Wade Cook’s *The Stock Market Miracle* and astrology readings in *Investing by the Stars*. There are books that appeal to pure greed, like *The Investor’s Guide for Making Megabucks on Mergers*, and *Midas Investing: How You Can Make at Least 20% in the Market this Year and Every Year*.

Get-rich-quick books tend to follow media events. The real estate boom in the late 1970s and early 80s brought on a rash of real estate speculation books. My favorite was

Nothing Down, how to make a fortune ripping off desperate home sellers. In the late 80s the Japanese economy was booming, which resulted in books like *Japanese Stocks: A Basic Guide for Intelligent Investors*, and *The Japanese Miracle*. Years ago, these books were best sellers everywhere, now they sell for a nickel at garage sales across the country. None of these strategies stood a chance of making money, except for the people who published them.

Mutual fund investing has seen tremendous growth in the 1990's. Naturally, there are several books on how to pick the best mutual funds. One popular book, *The Best 100 Mutual Funds You Can Buy* is a classic example. Every year self-proclaimed investment expert Gordon K. Williamson tells us which mutual funds to buy. Although, his *Best 100 Funds* book do not discuss past performance, I compared Williamson's 1994 fund picks in two important categories to see if he had any skill.

**The "BEST" Funds vs. Lipper Averages
July 1994 – July 1997**

	Growth Funds	Growth and Income
The "BEST" funds	22.9%	20.6%
Lipper Average for Category	23.1%	23.4%
Wilshire 5000 Index	26.7%	26.7%

Overall, Williamson's picks performed below average against the Lipper benchmark and significantly below the market average. Of the 25 funds in the study, only two performed better than the Wilshire 5000 broad US stock market index. In the back of the best funds book, Williamson boasts he is one of the most "*highly trained investment counselors in the United States.*" If this self-proclaimed God of investing cannot pick winning mutual funds, how can we mere mortals hope to succeed?

The New Media – Chat Rooms and the Internet

"Peer into my computer screen, and let us see what the future holds"

Crystal balls have always fascinated mankind. Soothsayers throughout history have made bold predictions of fame and fortune by peering into the glowing light of a crystal ball. In the modern world, computer monitors have replaced crystal balls, and Internet chat rooms have replaced the spirits from beyond.

Data Services and Analysis Programs

Watching lights blink on a computer screen and looking at stock charts all day may tell you what has already happened, but does little to tell you what the future looks like. A high-speed computer will not increase your investment knowledge or performance, but it may give you a tax deduction. Flashy investment software programs with a lot of graphics do nothing new to enhance investment returns, but they do receive data faster and crunch more numbers. Read the *Theory of Investment Value*, written by John Burr Williams in 1936. You will discover that basic investment techniques for valuing stocks have not changed in decades, only the speed of the calculations have changed.

Contrary to the claims found in advertisements, investment programs do not enlighten the user with special information. It is true that data can be obtained almost instantaneously, but data is not a substitute for real understanding. If you do not know what you are looking at, or how to analyze the information, the data is useless. Although mutual fund managers have all the computing power they want in hand, most have not been able to beat the basic market averages over the years. Speed is not knowledge.

Fools One and All

Internet investing is all the rage. There are thousand of investing web sites on the Internet offering everything from stock quotes to historic charts, and a variety of other services. These sites push investment products, news services, or whatever they can make a buck on. One popular site is the *Motley Fool*. It was started by a couple of college kids in the early 1990s. Just about everything you ever wanted to know about the markets can be found on the Motely Fool web site except clues to superior investment returns.

Mark Hulbert, editor of the *Hulbert Financial Digest*, monitored the performance of Motley Fool's model stock portfolios over the years. For three years ending in 1997, the Fool portfolios are not impressive. Hulbert found most model portfolios lagged the stock

market, and one lost a huge amount of money. As rule, the Motley Fool will discontinue a portfolio if it underperforms after a year or so. One defunct portfolio lost over 50% before it was discontinued.

The Motley Fool is not an investment advisor, so they are not required to report performance in accordance with industry standards. However, the jokers do try to maintain objectivity. One of the portfolios, the Motley Fool #2, did beat the market by a wide margin during a certain period. But that portfolio contained two hot technology stocks, which accounted for most of the gain.

Fraud on the Web

Many web sites offer investors the opportunity to swap ideas in an open forum called an Internet chat room. It has been my experience that a chat room is a place where you can have totally useless conversation about investing with someone who knows very little about the markets, but is convinced they know everything.

Chat rooms are also crawling with fraud. Stock operators try to manipulate prices by creating rumors and hyping stock. In early 1999, E-mail complaints to the SEC alleging Internet stock frauds were up to 300 a day, according to the General Accounting Office. Claims range from simple pump-and-dump schemes to sophisticated ploys such as counterfeit brokerage Web sites. Pump and dump is when a person buys thousands of shares of a penny stock, then releases favorable lies about the company over the Internet in hopes that the stock price will jump so they can sell their shares at a large gain.

Unfortunately, the SEC has not been able to keep up with the situation and fraudulent claims flourish. To further complicate matters, the SEC has recently lost more than 40% of their enforcement staffers in important markets like New York and San Francisco.

As millions of inexperienced investors sign onto the web, and hundreds of thousands of them opened on-line trading accounts, there is a growing belief that the Internet will lead to easy riches. If achieving superior returns was easy as buying a computer, logging onto the web, and trading tips in chat rooms, we would all be rich. In reality, there is a much higher probability you will be lulled into a stock manipulation scheme than there is that you will

achieve investment success. A Computer is a great tool, but common sense goes a lot further than the latest Intel processor.

Summary

Newspapers, newsletters, magazines and other printed media typically sensationalize their information in an effort to hold a reader's attention and attract new readers. The investment ideas in the printed press typically encourage harmful short-term strategies such as chasing the hot dot and market timing behavior. This results in a widening gap between investor's performance and the returns of the financial markets.

The printing press is a powerful tool. It can save lives and start wars, but it cannot tell you which mutual fund will beat the market next year. Following specific investment advice from a mass media source is generally not a good idea. Although the information seems important and relevant, unless you have a broad perspective and a deep understanding of the subject, it can do you more harm than good.

Individual investors spend hundreds of millions of dollars each year on investment information. But the money spent buying newsletters, newspapers, and magazines could be put to better use if invested in good quality bonds or a stock index fund. As Merton Miller says, the media will only tease you about investment opportunities you had best avoid.