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summaries

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Should Investment Advisory Newsletters Come With A Government Warning?

I receive inquiries from clients frequently regarding the capital markets, economics, their portfolios, or other similar matters. In mid May this year, I received the following from a fairly astute client:

"Bob,

I receive numerous investment and stock market information and found the article, "Fw: Stock Market: Last Big Buyer Calls It Quits?" somewhat concerning and would like to confirm with you that your view of the market is still positive. I know there is no way to time the market but maybe there are triggers that should be defined so if a crash occurs, we are in a position to maximize any gains while minimizing any losses.

Let me know your thoughts,

Signature"

My response:

"Hey ***Name***:

I appreciate your sending this and giving me an opportunity to weigh in.

I preface by again acknowledging that I am not smart enough to be able to predict markets.

Looking at this piece, as you know, the author calls into question the resilience of equity prices given the apparent pullback by big corporate buyers of their own stock.

There are probably myriad reasons for this, not the least of which being that buybacks require board approval as to amount and timing. New approvals could be forthcoming. Or, perhaps companies no longer think their stocks are good value???

Or, perhaps, yet another possibility; yesterday's Wall Street Journal carried the story of a Senator (Orin Hatch, I think) suggesting a revamp of the tax code to allow corporations to deduct dividend payments. If this were to become law, most companies would redirect their cash flows from buying back stock to paying deductible dividends. It leaves shareholders with more money. I would suspect that this could also be a consideration and maybe the most credible.

Hence, there may be more to the story.

Let me know if you have additional questions.

Best,

Bob Bilkie"

I think this exchange was educational for two reasons. The first relates to the veracity (or lack thereof) of stock market timing –trying to sell when things appear "high" and buying when "low." In over 30 years of practice, I have never found an individual or entity that could do this successfully and with replicable consistency. It just does not happen.

The second reason has to do with the dynamics of the investment advisory newsletter business. There are hundreds, or maybe thousands, of newsletter writers around the globe. All of them have a single purpose – to sell you something.

There is a fertile field for stock market newsletter writers. It goes without saying that human beings are wired to seek self preservation. Numerous articles have been written about the "fight or flight" instinct. Clearly, there is an innate need to be alerted to any looming disaster - be it a Tiger pouncing or a pending financial apocalypse. So certain investors seek out the "seers" that can warn them of disasters.

In the wild, if one is warned of an attack (pounding footsteps and crackling twigs and branches) then evasive action can be taken. If the attack does not take place, there is little lost save the energy to get out of the way and hide. On the other hand, if the warning was not heeded and the attack did occur, loss of life is likely. It makes perfect sense.

In the financial forest, however, the typical "evasive action" entails liquidating quality investments. Oftentimes, this generates capital gains, commissions, etc. If the market correction does not occur, these costs were unnecessary and before positions can be re-established, the market may be higher, resulting in opportunity loss. Even if a correction takes place, it is often difficult to assess the bottom and get back in at an advantageous time. Once it is clear that the risk has subsided, the market has typically rebounded well in advance.

Thus, nervous investors find themselves in trouble because they could not restrain their emotions and end up selling at the bottom, buying at the top, and seeing their portfolios dissipate as a result. Investors of this ilk would do far better by completely avoiding any volatile asset and instead, learning to live on the very modest (sometimes negative) returns of ultra-safe asset classes.

But, one final comment about investment advisory newsletter writers. While I am certain that there are many that are well intentioned, they know with certainty that they will not succeed in selling their services if they are not bold and provocative. They must APPEAL TO THE RAW EMOTIONS OF readers in their solicitations and use fear as their primary motivator to get a sale. Otherwise, their efforts will be fruitless. While the financial cost to the investor can be significant, the authors of these advisory newsletters are left relatively unscathed. Who is going to fault them in their desire to protect?

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