Advisor

Strategies and Insights

Also:

Reading Your Way to Riches

> ***Whether you invest according to lunar cycles or modern portfolio theory, there's a newsletter out there that will sell you advice***

By Nick Ravo

Surely, somebody out there subscribes to the *Hanover Intermediate Term Trader*, *Whitfield's Utility Letter*, the *F.X.C. Newsletter*, or *Bob Carver's Market Clues*. And doubtless scores of investors won't make a move without the latest issue of Russ Kaplan's *Heartland Adviser*, which offers "in-depth Omaha-style analysis as popularized by Warren Buffet [sic]," according to the promotional literature.

"Omaha-style analysis"?

Ah, the tip sheets (also known as newsletters, or market letters, if you want to get formal). Whimsical, occasionally wise, and often amazingly wrong, market newsletters number in the hundreds—500 is a common estimate.

Even the august *Wall Street Journal* began, in 1883, as the *Customers' Afternoon News Letter*. But the golden age for these publications dawned in the 1970s, when deregulation of the brokerage business prompted people to make more of their own financial decisions. Today, there's something out there for almost everyone. The choices range from *The Moneypaper*'s general economic prognostication, personal-finance advice, and model stock portfolios to *The Option Advisor*, which deals exclusively with options strategies, to the *Dick Davis Digest*, a newsletter that samples other newsletters.

Newsletters appear weekly or monthly, run between 8 and 16 pages, and cost a lot—$69 to $250 per year is typical, and much higher fees are not unusual (though free or cheap trial subscriptions are quite common). The big ones, like the *Value Line Investment Survey* and the *Standard & Poor's Outlook*, have tens of thousands of subscribers. Others, like *Harmonic Research*, which uses solar and lunar eclipse cycles to "confirm its technical analysis," have perhaps a few hundred.

But are they worthwhile investments? After all, anyone with some newsletter-publishing software, a roll of stamps, and a hunch about the market can put one out.

"The proportion of newsletters that beat the market over the long haul is about the same—between 20 and 25 percent—as it is for mutual funds and professional money managers," says Mark Hulbert, publisher of the *Hulbert Financial Digest*, a newsletter based in Alexandria, Virginia, that ranks the performance of financial newsletters.

Newsletters are often a valuable source of information, according to Hulbert, whose digest, published since 1980, has become the *Consumer Reports* of comparative newsletter performance. Newsletters cover sectors often avoided by mutual funds and money managers, like micro-cap stocks, special situations (usually mergers and acquisitions), and medical technology. And unlike brokerage houses and sell-side

Cary Henrie

research analysts, says Hulbert, newsletters have little or no vested interest in the stocks they recommend. They can be very useful, too, for investors who have a strategy and simply need the discipline of a model portfolio to follow it.

"That may be the major benefit," Hulbert says, "helping investors focus on a single strategy through thick and thin."

Hulbert derives his rankings from model portfolios created from the advice offered by the newsletters. While he cautions that investment records sustained for less than five years are not a predictor of future results, long-term performance, particularly ten-year returns, appears to be more predictive, as the luck factor evens out over time.

He also cautions against combining the strategies of various newsletters. "I am less inclined to think that mixing and matching makes much sense even though you would think, in theory, that it would," Hulbert says.

"Almost any method, in the right hands, can work," says one publisher. "And in the wrong hands, almost any method can't work."

The best-performing market letter by Hulbert's ten-year return criteria—by a wide margin—is Louis Navellier's *MPT Review*, up almost 1,000 percent in a decade. Navellier, a quantitative analyst, uses modern portfolio theory and computer programs to bet on inefficiently priced "high-alpha" stocks (stocks rising faster than the market). He also offers an unusually high number of stock recommendations.

Navellier, 37, became enamored with modern portfolio theory while studying for his M.B.A. at California State University at Hayward. The theory, based on research by Nobel Prize winners William F. Sharpe and Harry Markowitz, holds that it is possible to maximize return while minimizing risk, based on a belief that the market is efficient and that index funds are the best way to invest. Navellier, however, uses the theory to show that the market is only about 84 percent efficient. He looks for stocks in the other 16 percent by screening about 21,000 stocks each week before whittling the buy list down to about 400.

Besides his 14-year-old newsletter—which costs $225 annually and has 7,000 subscribers, about half of them brokers or institutional investors—Navellier also runs a money-management business with more than $1 billion in assets.

"My motive was different from a lot of people who put out newsletters," Navellier says. "I was an academic, and I just wanted to establish my theory."

The worst ten-year performer according to Hulbert, also by a wide margin, is the *Granville Market Letter*, which lost 96.7 percent in the decade ended April 30, 1995. Joseph Granville, who charges customers $250 a year for his weekly newsletter, which has been around since 1963, has long been a critic of Hulbert's ranking technique, especially the averaging of various model portfolios to create one total return for a newsletter.

Granville is best known for having divined that the market was about to plummet and advising his readers on January 6, 1981, just as the Dow Jones Industrial Average broke 1000 for the first time in years, to "Sell everything!" Thousands did, and the resulting flood of orders was widely credited with causing the Dow to fall 24 points. Unfortunately, those investors who stuck with the bearish Granville in the following years missed out on the historic bull market of the 1980s.

Interestingly, there appears to be no correlation between investment strategy and success or failure. "Almost any method, in the right hands, can work," Hulbert says. "And, in the wrong hands, almost any method can't work." In other words, a precious-metals newsletter is as likely to perform well or poorly as one devoted to value investing or penny stocks.

But one detailed study did demonstrate that market-timing newsletters were about as accurate as flipping a coin. Campbell Harvey of Duke University's Fuqua School of Business and John Graham of the University of Utah's Eccles School of Business studied the recommendations made according to 237 market-timing strategies in 100 letters between 1980 and 1992.

The study, released last May, found that the market rises only 48 percent of the time after market-timing letters recommend increasing equities and decreasing cash in asset allocations. The market falls only 51 percent of the time following a call by market-timing letters to reallocate portfolios with more cash and less stock.

"If the choice is between a buy-and-hold strategy and listening to asset-allocation recommendations in these newsletters, you are better off with buying and holding," Harvey says.

Not only was the overall performance of market-timing letters poor, but just eight newsletters in the study, which was published by the National Bureau of Economic Research, had substantial positive performance. "That number is, statistically, what one would expect if the strategies [employed by the letters] were randomly selected," Harvey says.

The winning market-timing newsletters were *The Chartist's Actual Cash Account*; *Investors Intelligence's Switch Fund*; *Overpriced Stock Service*; *Switch Funding Timing's Conservative Strategy*; *No Load Select's Timing Strategy*; *Closed-End Funds IV*; *National Trendlines' Stock Timing Strategy*; and *Bob Nurock's Advisory*, which had two successful strategies, TMI: Shorting and TMI: No Shorting.

At the bottom of the survey was, once again, *The Granville Market Letter (Traders)*, which lost an average of 0.4 percent annually over the 12-year period.

"This is, in my opinion, remarkably hard to do," Harvey says, referring to Granville's performance. "Just putting your money in a savings account would beat that, and it compares quite unfavorably to the annual return for someone who bought and held the Standard and Poor's 500 over that period."

In any case, market-timing letters are not the current rage in the notoriously faddish the SEC, Leeb said an investor using his market-timing program, Master Key, could have turned $10,000 into more than $39 million from 1980 to 1992. But the SEC claims the results could have been obtained only by retroactively applying a constantly updated version of the program. According to the SEC, many strategies included in the constantly updated program were not developed until after 1980. Thus, no one could have realized the advertised gain—even hypothetically.

Performance puffery, though, is common in the market-letter business, so caveat subscriber—this is a largely unsupervised market. In June, the Commodities Futures Trading Commission requested that commodity and financial-futures letter writers register as commodity trading advisors, even though the Supreme Court has ruled that market letters are bona fide publications, which suggests that such licensing or registration would constitute an unconstitutional infringement on free speech. Only if the publishers are also investment advisors, as defined by the SEC, must they register as such with the commission.

Still, Peter Brimelow, a senior editor at *Forbes* and author of *The Wall Street Gurus: How You Can Profit From Investment Newsletters* (Minerva, 1986), says that most newsletter publishers "are not getting any commission, and they only succeed if they make money for the subscriber."

He's right, at least insofar as his description holds. But some publishers try to have it both ways. George Chelekis's *Hot Stocks Review*, one of the few financial newsletters available on the Internet (America Online's popular Motley Fool stock forum is also available online), focuses on small Canadian stocks and derives some of its income from research fees paid by some of the companies he writes about, often glowingly. By law, such interests generally must be disclosed, which Chelekis does. Nonetheless, in the eyes of some, this would make him a stock promoter rather than a newsletter publisher.

In the end, says Mark Hulbert, "People should subscribe—but they should be skeptical."

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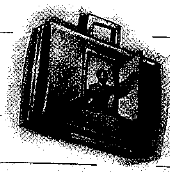
Advisor  Briefs

ONLINE SMALL-BUSINESS ADVICE

Lexis-Nexis, the Dayton, Ohio–based information company, and Open Market, Inc., a Cambridge, Massachusetts, computer company, recently introduced an Internet database called the Small Business Service. For as little as $1.95 an article and zero browsing costs, Net surfers can access 8,000 stories on small-business issues. "Lexis-Nexis can give small-business directors an edge on their competitors," says Jim Weidman, a spokesman for the National Federation of Independent Business in Washington, D.C. Subjects range from capitalizing a start-up to legal changes affecting small businesses. To use the service, log on to World Wide Web site http://www.directory.net/lexis-nexis/sba.

LATEST ANNUITY TARGET: WOMEN

At the behest of SunAmerica, a Los Angeles retirement-services company, the National Center for Women and Retirement Research in Southampton, New York, recently surveyed roughly 1,500 women about their retirement plans. The survey disclosed that women spend more time and money planning their wedding than their retirement. Also, 90 percent of respondents avoided retirement investing because of high capital-gains taxes, while only one third fully understood the capital-preserving qualities of annuities.

SunAmerica promptly began targeting women for its annuities. But the company didn't tell prospective customers that, as of the first quarter of 1995, variable-annuity sales have plunged to $2.1 billion, from $12.3 billion a year earlier, according to Lipper Analytical Services. In part this was a result of the bond market's poor 1994 performance. Says Eileen Sharkey, a Denver certified financial planner: "Annuities should never be the only retirement vehicle for an investor."

NONTOXIC MUNIS

The Orange County financial crisis and the more recent downgrading of Washington, D.C., bonds have called attention to the general murkiness of the municipal-bond market. Reporting requirements are lax, making it difficult for investors to check for fiscal soundness. One option, according to the accounting firm Ernst & Young: Insured bonds. Nearly 40 percent of all municipal bonds will pay 100 percent of principal and interest in the event of default, says the Public Securities Association. Municipal-bond funds invested primarily in insured municipal bonds outperformed uninsured municipal funds by 1.27 percent during the first five months of this year. Keep in mind that so-called insured bond funds are required by law to stash only 65 percent in insured bonds.

GUNNING FOR DERIVATIVES

Last May, *Worth* reported that the Internal Revenue Service wanted to attack derivatives. The agency is now set to aim and fire: In early 1996, the IRS will crank up a pilot computer program to help auditors calculate the difference between a derivative's discounted purchase price and the price it is expected to fetch in a given period of time. The program, developed by the Los Alamos National Laboratory, will help the IRS reconstruct market conditions at the time of the taxpayer's investment, allowing its agents to determine whether he properly reported gains or losses. Those who have done so incorrectly will have to pay up.

THE DERIVATIVES-MESS MARKET

Investors can now capitalize on the imminent IRS crackdown on derivatives as well as the havoc the instruments have caused. C*ATS Software of Palo Alto, California, a derivatives-analysis software company that makes software to manage the structuring, pricing, and trading of complex derivatives, filed an initial public offering of 2 million shares at $12 last March. The IPO exceeded the maximum filing range of $11, according to *The IPO Reporter*. The stock is now trading around $11. The software is also used in back-office operations for processing, settlement, accounting, and reporting and is used by six of the world's ten largest commercial financial institutions. Says Norman Fosback, president of the Institute for Econometric Research: "We see a bright long-term future for this company."

—Elizabeth Macdonald and Maxwell G. Dale