

SOME INVESTING MYTHS

A prudent investor in the securities markets needs to know about investing techniques, trading platforms, investment products, and the various professionals who can assist him. If you are a beginning investor start by reading the Wall Street Journal Guide to Understanding Money & Investing. It contains lots of diagrams, tables & charts; plus definitions of the basic terms you need to know. Books by or about Peter Lynch and Warren Buffet are classics for folks who want to pick individual stocks. Both were superior investors. You can also find extensive information on-line at MSN and Yahoo. Fidelity.com and Vanguard.com have thoughtful information on investing, taxes, estate & financial planning, along with detailed profiles of the mutual funds in their brokerage supermarkets. Morningstar.com has more extensive information about stocks and mutual funds for intermediate and advanced investors. You can even sign up for one of their on-line classes. The iShares.com site is a good resource for advanced index fund investors.

There are a tremendous number of misconceptions about investing in stocks and equity mutual funds. Here are a few:

1. Myth: Index funds are just average.

The table below shows the percentage of open-ended mutual funds with annual returns **below** the major Standard and Poors (S&P) US stock indexes over the 5, 10, and 15 year periods ending on March 31, 2002. The index numbers were reduced by the current BGI iShares management fee and all of the returns are after tax. Morningstar and Standard & Poors supplied the data. An index is a group of stocks used to measure the performance of a particular category. An index mutual fund holds all of those stocks.

S&P Index	5yr	10yr	15yr
500 Large Cap	85	93	90
400 Mid Cap	97	98	98
600 Small Cap	85	95	82

Fact. The S&P index funds trounce most actively managed funds over every time period.

2. Myth: Buy only when stocks are super cheap.

We did a study using 20 years of data for the Vanguard 500 Index fund from 1976 through 1996. Three hypothetical investors put \$2,000 into their IRA each year. Bill Brilliant bought at the lowest price each year, Ari Airhead bought at the highest price, and Pete Plodder bought on the first trading day of each year. The table below compares their results.

The Investors	Strategy	Ending Amount	Annual % Gain	% less than Brilliant
Bill Brilliant	Buy Low	\$290,878	15.61%	0
Pete Plodder	First Day	\$270,276	15.05%	.5%
Ari Airhead	Buy High	\$238,520	14.11%	1.5%

Fact: Long term compounding overrides other factors. Buy as soon as you can.

3. Myth: You have to be an skillful active trader to make money.

Delbar Inc. of Boston studied the investment results of thousands of individual investors over the 17 year period from 1987 to 2002. The results are shown in the table below. Investors averaged 5.32% a year while the S&P 500 index gained 16.29% a year. Investors lagged the index by 11% a year, and the major culprit was excessive trading. Extensive trading generates transaction costs, creates tax bills in taxable accounts, and reduces your net return. Investors tended to buy at the market peaks [when they felt good], and to sell at market troughs [when they felt terrible]. Wise investors do just the opposite.

	Total Gain In 17 years	Annual % Return
Investors	\$42,139	5.32%
1 Yr T-bill	\$83,338	6.86%
S & P 500	\$705,847	16.29%

Fact: Long term investors with low turnover always win.

4. Myth: Focus your energy on picking the best stocks and bonds.

A study reported in the *Financial Analyst Journal* in the July-Aug 1986 issue, and updated in the May-June 91 issue, concluded that asset allocation accounted for 91.5% of portfolio performance. Stock Selection and market timing only accounted for 8.5% of the performance. Asset allocation describes how a portfolio is divided into different asset classes. The table at the bottom of the page lists some of the most important asset classes.

Portfolio Task	Percentage
Asset Class Selection	91.5
Stock Selection & Market Timing	8.5

Fact: Your asset class selection is far more important that the specific securities you buy. [unless you can pick stocks like Warren Buffet]

Equity Asset Class	Income Asset Class
US large cap	Money market
US mid cap	US Treasury bond
US small cap	GNMA bond
Foreign small mid cap	Corporate bond
Foreign large cap	Foreign bond
Real Estate Inv. Trust [REIT]	Bank notes
Natural Resource Company	High Yield bond