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Thoughtful Wealth Planning & Management

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"Who are you going to believe, me or your own eyes?"

–Groucho Marx

Whisper

Numbers

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The ad was enticing. . .

It said:

"Retire Early & Wealthy. People just like you are becoming millionaires. We'll introduce you to seven online investing strategies. If you're serious about your investments, you owe it to yourself to attend this FREE seminar."

I went, and I am trapped. No, I am not fascinated by the seminar sponsor or its ideas. No, I cannot use its ideas. The trap is intellectual, a circle having no escape. I enter the circle wanting to criticize, but knowing that my criticism may have no enduring value because it is self-serving. In the act of criticizing, I place myself as a potential object of criticism, because I engage in the same behavior I wish to challenge. An example of this intellectual trap is the statement by a husband to a wife: "Dear, you are too negative and critical." By so arguing, the husband is guilty of the same act/attitude he attributes to his spouse. By criticizing the sales techniques of the sponsor of this "seminar," techniques that included frequent and subtle criticisms of other providers of investment services, I inescapably enter a thought-prison.

But this seminar was *gooood*, one of the best, very effective. It was as tight as a Broadway show. Its goal was not to teach. Instead, it enticed listeners by superficially describing well-known investment techniques and by ascribing great success to use of those techniques. The data delivery was fast and furious. No listener could understand the techniques or appreciate their risks. Too much, too fast, too soon, too complicated, but ooh so enticing. Technically, the seminar was not deceptive, because the speaker acknowledged that no one could learn in 90 minutes. He said that the way a listener could learn is by attending the next event, a two-day seminar, including breakfast and lunch. **The cost: $3,995**. "Give us your credit card number now to reserve your place at this valuable seminar. You can cancel later, but by giving us the card number now, you will have a guaranteed seat at this marvelous event."

Why will individuals attend this seminar for almost $4,000? Here is a summary of the very convincing sales techniques, their implications, and the facts.

Sales Technique I: Smooth delivery

The speaker is well-dressed. He is articulate, funny, down-to-earth, and well-groomed. He exudes personal success, and self-confidence. "I trust him. I can be like him," think listeners. The computer-generated visuals are sophisticated and precise. Moving arrows highlight important points. The presentation is on time, fast, concise. Harold Hill, "The Music Man," could do no better.

Sales Technique II: Success was theirs, now yours.

According to the presenter, Professors Donald F. and Mildred Topp Othmer of Brooklyn Polytechnic Univer-

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sity started with $25,000, and left an estate of over $800 million. How did they do it? We do not know. Maybe they were friends of legendary investor Warren Buffett. The unstated message is that the proposed two-day seminar and the professors' success are connected. Right? Wrong, of course. The proposed on-line investing techniques did not exist during most of the lives of these successful investors, but maybe, just maybe, "you, too, can have $800 million."[1]

While we are at it, let's reference Einstein, Peter Lynch and Warren Buffett. Einstein said that "the greatest invention of mankind is compound interest." No one can prove Einstein said it, but what the heck, the premise is sound. Did Peter Lynch endorse this seminar and its techniques? Probably not, and the speaker made no such claim, but the slide showing his book, *One Up On Wall Street*, is impressive, as are the frequent references to Warren Buffett. "In fact, you can learn exactly what Warren Buffett is doing, by following the insider-trading data that we will give you." Easy. Right?

Sales Technique III: Performance

"Did you know that most pension plan investment managers, and most investment newsletters, under-perform the market?" Unstated implication: you can do better than the professionals, "by listening to us." Unstated truth: most professional investors perform below the results of market indexes, because reported results of market indexes do not include transaction costs and other unavoidable expenses that all investors must pay. The indexes are only an approximation of reality. Unstated truth: three studies by a professor of finance, using data provided by a large discount brokerage firm, demonstrate that on-line investors earn rates of return far below both indexes and buy-hold investors.

The presenter continues: "Did you know that most brokers never call to tell you when to sell? Is it not more important to know when to sell than when to buy? Shouldn't you check everything that your broker tells you, perhaps by referring to our data and our system?" Implication: brokers are not good sources of advice. "We are a better source of advice." Truth: brokers are humans who work in human organizations, just like the speaker at this seminar, and no one knows which source of advice has the best track record.

Sales Technique IV: Easy Money

"Have you heard about covered calls? These are not puts and options. They are safe covered calls. They are so safe that the Internal Revenue Service allows you to use them in your Individual Retirement Account." Implication: the U.S. government endorses covered calls. Truth: the IRS endorses nothing. It only permits a specified activity within a tax-deferred account.

"The returns on covered calls are terrific. For example, you can buy a stock at $13, immediately receive $1.50 per share in proceeds from the sale of a covered call, and sell the stock three months later for $15. The total return is 12 percent in three months, or almost 50 percent per year, right?"

Implication: "come to our seminar for $3,995, learn the technique, and make lots of money, safely." Truth: premiums (the amounts received on sale) on three-month calls rarely reach the quoted 10 percent of a stock's market price, and most stocks purchased for $13 cannot be sold three months later for $15. Many decline. If this "seminar" to sell a seminar had one big whopper, this was it.

Sales Technique V: Testimonials

Dozens of testimonials, all shown as emails, without complete names or return addresses. "We are a public company," he says. "These are all on file." Truth: for most of us, checking the accuracy of the testimonials is impossible, and even the most successful, reputable organizations receive two or three negative letters for every positive letter. May we see the negative letters, Mr. Presenter?

At this point, I left, confident that out of the audience of perhaps 150, 15 people will spend $3,995 for a two-day seminar to acquire information that is widely available at no cost by consulting with professionals, or at minor

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[1] The Othmer's had a combined estate of over $750 million, and left $175 million to Polytechnic, the largest lump sum cash gift ever given to any university. He was a "world-renowned" chemical engineer and a professor at Polytechnic since 1932. The story was publicized in the *New York Times* in July, 1998. However, no one confirms that the starting amount was $25,000 or how much might have been added over the years. Some professors make large incomes from consulting, writing, and discovery. Apparently, a large portion of the estate was in Berkshire Hathaway common stock. Berkshire Hathaway is managed by buy-hold-long-term-investor Warren Buffett, who would turn blue before engaging in the techniques espoused by this presenter.

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Whisper Numbers

Investors want a "system." A system is an analytical procedure to determine value, or when to buy and when to sell. Most systems have elements of automatic response. A buy or sell action by an investor is supposed to follow a prescribed event. The never-ending search for systems has produced an odd juxtaposition of systems, with each new system depending on a previous system (or set of data), like a pyramid. A recent addition to the pyramid is "whisper numbers."

A "system" always starts with data, usually a single series, such as earnings per share. Countless data series are available: book value, sales per share, insider trading, volume of purchases and sales of company stock, moving averages, beta, standard deviation, and hundreds more. The thinkers and strategists build their systems on one of these data series, or several series in combination. Earnings per share probably was one of the first data sets about public corporations, because the information arises naturally from corporate accounting. The earnings per share of a company is the net, after deduction of all expenses and taxes, divided by the total number of shares outstanding. If a company has total revenues of $10 million, and total expenses including taxes of $8 million, the net profit before dividends is $2 million. If this company has 1 million shares outstanding, the earnings per share is $2. If the company distributes 50 cents per share as a dividend, $1.50 is left in the company to buy new assets or to conduct research. This amount, $1.5 million, is tangible growth. The company is worth $1,500,000 more this year than last year, because this is the amount of net earnings reinvested. In the search for improving value, what statistic could be more important than this?

Once a data series is collected and codified, the next step is to analyze, to measure meaning. An obvious hypothesis is that growth in earnings is important. If one company earns $2.00 this year, and $3.00 next year, its prospects must be better than the company that earns only $2.10 next year. This observation naturally leads to a new data series: annual percentage growth in earnings per share. With the arrival of easy-to-use computer calculation systems and improving data storage capacity, maintaining and distributing enormous amounts of this kind of information is easy. With each new data series, thinkers create new methods of analyzing. One attempt was to measure "the quality of earnings," an analytical tool recognizing that companies have wide discretion over how to compute earnings per share. But that is another story.

If earnings per share and growth of earnings per share are significant measures of value, then accurately predicting future earnings is an obvious source of personal profit. If I accurately predict that company A's earnings will grow at 20 percent, and company B's earnings will grow at 50 percent, I will make more money acquiring the stock of company B. This simple premise led to creation of the profession of securities analyst. Today, Wall Street employs thousands of analysts, all dedicated to predicting earnings per share. The futility of this effort not withstanding, these analysts are "the experts" quoted in the media. With over 14,000 stocks trading in the United States, and some companies followed by a dozen or more analysts, and each analyst forecasting results for the next quarter, the next year, even the next three years, imagine the volume of new information. The information is not historic fact. Instead, it is a compilation of forecasts. Imagine the potential for services that publish and analyze this compilation. One such company is First Call. It collects predictions of earnings. Usually, the "consensus" earnings forecast mentioned in the media is an average of earnings forecasts collected by First Call. First Call maintains the second level of the information/strategy pyramid. The first level is real earnings. The second level is forecasts of earnings. The second level includes forecasts of all analysts, categorization of forecasts, and analysis of forecasts. We can observe the trend of forecasts. We can calculate the mean of a group of forecasts, as well as the difference between the high forecast and the low forecast. If we want to get really huffy, we can calculate the standard deviation between forecasts and build an investment system on these standard deviations. We might propose the hypothesis that companies having a larger standard deviation of forecasted earnings per share are more likely to be profitable investments than companies having smaller standard deviations. (This is similar to believing that we should bet on the horse with the highest odds.) If we build a system based on the standard deviation of forecasts, we have assumed predictive validity of a series of numbers (standard deviations) that is derived from another series of numbers (forecasts). Unfortunately, no one ever has shown that forecasts of earnings per share are accurate. Most of the time, they are not accurate. This reality eludes devotees of any system based on forecasted earnings per share. These folks enjoy the numbers and attempting to make sense out of numbers.

Until approximately five years ago, the only raw data available on which to build an earnings-per-share-based system was the compiled and categorized published forecasts of professional analysts. At some point, someone, somewhere, said "maybe published forecasts are not the whole story. Maybe analysts give one set of information in printed

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Whisper Numbers, *continued from page 3*

reports, and another set in private conversations with large institutional clients. Perhaps companies manage earnings forecasts by giving private tips to select analysts, or perhaps companies leak earnings forecasts to favored journalists, or to favored employees. Maybe, just maybe, these informally distributed "whisper numbers" are more accurate or more meaningful than the published forecasts of professional analysts. What is the best way to collect and to distribute these "whisper numbers?" No question about it: the Internet. At least five Web sites collect and publish whisper number earnings forecasts for companies, deriving their data by searching "through hundreds of thousands of data sources on a daily basis with a constant scan from our full-time data miners, full-time news reporters, operations manager, specialized programmers, and two directors." Another site says, "our first source for a whisper number is a contact associated with the company—an officer, employer, or an accountant working within the firm."

Apparently, Web site sponsors obtain whisper numbers from anonymous sources, by undefined proprietary means. Sources appear to be chat rooms, surveys of web site users, voluntary inputs by users, and possibly insiders. Whisper numbers make up a new data series, gathered by new Internet companies. Before long, we will have a service to evaluate the quality of whisper numbers, and investment techniques will arise based on the measured difference between whisper numbers and actual numbers reported by companies.

The search for relationships between data and stock market success never will end, and the intellectual distance between a fact, such as real earnings per share, and phantom numbers based on fallible human predictions, will expand. Investors want simple ways to make money. They want "signals" to buy or to sell. Entrepreneurs want to earn monthly fees by creating, compiling and categorizing new forms of data. They seek new ways to use the data, new systems that can be packaged and presented at seminars for $3,995. They want investing to be as easy as deciding what to wear based on the weather forecast.

The ad was enticing, *continued from page 1*

cost by reading books. Of the 15 people who attend the two-day seminar, five will practice the techniques described. Of the five, four will drop out of the system after experiencing their first loss. After three years (approximately one market cycle), the one hold-out will drop out.

The investment strategies promoted by this "seminar" sponsor are legitimate, but implementation is not easy. Twenty minutes a day on the Internet is not enough to make a successful investor, and most investors do not have the fortitude to continuously and faithfully follow technical trading techniques. The person who wants to grow net worth from stock market investments must read, talk to professionals, practice, make mistakes, but continue despite inevitable setbacks. The best way to learn is to invest the $3,995 in a stock, not in a seminar.

But who am I to talk? Why listen to me? That I advocate long-term, personal, interactive relationships between professional advisors and clients is merely another investment technique, with no more clearly proven value than selling calls or using technical timing. By criticizing them, am I not merely enhancing myself? How do I get out of this thought prison? You decide.

Your date with investments

Every Tuesday, the *New York Times* reports "how $100 invested four weeks ago in a portfolio replicating each sub-index of the Standard & Poor's 500 would have fared through yesterday."

On June 5, the $100 "invested four weeks ago" in the industrial sub-category was worth about $102, up 2 percent in the four weeks since May 5. If one invested on May 12, and sold on June 12, the result was $98. From May 19 to June 19, an investor saw a decline to $94. For the four weeks ended June 26: $97. July 12: $94.50. July 18: $99.[2] Conclusion: results over one-month periods depend entirely on when money is available and the day an investor selects to invest.

Question

Who manages your money? Someone you know, such as a personal wealth manager, or someone you do not know, such as a mutual fund manager. Which do you prefer? The fallible person you can call, or the fallible person you cannot call?

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[2] These dates were selected randomly, depending on whether I both read the *Times* and clipped the data on the reported date.

Good Night Dorothy. You done good.

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