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### Personal Finance

## "I WAS TAKEN!"

Our imbedded fear of being "taken" reduces the joy of travel.

Suppose, for example, that we purchase a bunch of bananas for \$1.50 from a mobile vendor who approaches our rented car or chartered boat. A few hours (or minutes) later, we see a bunch for sale at 75 cents, usually at a public market several miles (or several feet) away. In this circumstance the reaction of an American ranges from calm acceptance to the more common open expression of indignation to the unusual, but not unknown, outrage that causes shouting and a chase to find the mobile vendor and to seek a refund.

"I was taken," we say. "I won't have it." Pain is incurred and energy expended in these encounters. Even those of us who react initially with quiet aplomb, frustration builds, and we protest to friends, over cocktails, for weeks.

Back home, on the other hand, we are "taken" almost daily. The sophisticated science of food store marketing is based on the loss leader. Every day, food stores advertise bargain prices on a few popular items such as meat, eggs, film and wine. Food stores know that shoppers purchase more than the bargain items. Usually, shoppers purchase items worth hundreds of dollars more, paying regular prices.

When the shopper checks out, he/she, on average, has spent enough to generate the profit required to keep the food store open. The shopper is happy to have found the bargains, and the food store is happy that this shopper purchased many other items at the normal mark up.

A few weeks ago, my wife laid in a good supply of after shave, five bottles if I recall. The price per bottle at the large food chain was over \$4.00. Later in the same day, by coincidence, she stopped at one of the "dollar" stores where she saw the same product (with a slightly different label) for sale at about 90 cents. She bought five more bottles, and returned the first bottles during her next regular visit to the large chain, saving more than \$15.00.<sup>1</sup> Was she "taken" by the large chain? Of course! Well, maybe not. The large chain store always offers some products at sale prices. It is convenient. She can find everything she wants in one visit, saving both fuel and time.

She knows where to find things at the store. She likes it, enjoys it, feels good shopping there. She exhibits no indignation about this incident. Instead, she has a good feeling about the "dollar" store, while having no negative reaction to the large chain store. She feels "lucky" to have found the bargain.

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<sup>1</sup>I hope that this product is identical. If my face begins to turn yellow, well, you know. . .

# Rate of Return

Investors want a high rate of return, right now, all the time. Providers want to give a high rate of return and to attract new clients by advertising high rates of return earned in the past. Both parties mine data. They artificially seek data that fulfills their expectations and objectives. Either to seek a sense of achievement and contentment or to criticize and dismiss a provider, individual investors unknowingly mine data. To attract new clients, providers knowingly mine data to make themselves look good.

Investors who by intuition and temperament want to place funds with a particular investment sponsor are attracted to statistics giving a position of superiority to that sponsor. For example, if an investor is predisposed to a technology fund sponsored by XYZ mutual fund, he or she will look at favorable numbers and will discount unfavorable numbers. The investor will look at the superb one-year performance while either ignoring or giving less weight to the five- or ten-year record. This tendency to seek a favorable record is neither conscious nor entirely avoidable because we all need to justify our decisions. A similar phenomenon happens on the world

stage. A critic of a national administration sees “the highest deficit in history,” but a supporter sees a deficit of only 5 percent of GNP compared to 30 percent of GNP after Pearl Harbor. Mining for supporting data ratifies a decision and defends against skeptics.

Sponsors of packaged investment products such as mutual funds, commodity trading partnerships and hedge funds present good performance by picking a start date and an ending date that provides the most positive statistics. The benchmark statistic is rate of return, a number that looks great, moderate or poor, depending on conscious or unconscious choices inherent in the mining of the data. A reality appears by managing choices, but the important reality is that rate of return is chaotic, irrational, beyond comprehension, and often irrelevant.

Three tables show the chaotic nature of this powerful statistic. The tables are identical in most respects. Each has a final end date of June 30, 2003. The left column shows three-month periods (calendar quarters) ending on the listed intermediate date. The right column is the percentage appreciation of the S&P 500 index for one quarter only. If the index started January 1 at 10 and ended March 31 at 11, the index return is 10.00 percent.<sup>3</sup> The center column is the cumulative return of the index over each extended time period.

In Table I, A Longer Haul, the starting period is the quarter ending March 31, 1998, and it produced a 13.53 percent appreciation. During the next quarter, the appreciation was only 2.91 percent, giving a center column cumulative return of 16.84 percent, the sum of the two consecutive quarterly returns.

In constructing these tables, we have mined the data. The end date of June 30 is a convenience. It is the end of the most recent quarter prior to publication of this newsletter. We could have used July 31, or perhaps even August 10, and the result would be different numbers, possibly radically different numbers, but we prefer the convenience (less work). The start dates are arbitrary. In Table 1, we selected the first quarter of the first year after the inception of our firm. Table 2, A Shorter Haul, starts at a recent high in the S&P index. Table 3, A Short Haul, starts near the recent low in the S&P on October 1, 2002, because we knew that any statistic starting then would produce a positive number. We selected these dates almost on whim, because the world of rational thought gives us no universally applicable criteria to make universally applicable conclusions. If we had wanted, we could have selected start dates that produce fabulously positive statistics. If we were governed by some form of death wish, or by pessimism, the dates selected could have produced very negative results.

The differences in these tables are large. Table 1 shows a cumulative index return of 0.08 percent. Table 2 hits hard with a negative 12.25 percent. Table 3 gives joy: up 19.53 percent. Who can make sense of this? No one, and a glance at the results of each quarter in the right column of Table 1 shows an astounding variation in results.

Our challenge to understand is further complicated by the fundamentals of the statistic. It is an “index” (not an average) of 500 stocks. Who owns 500 stocks? Who owns these 500 stocks? Nobody. Who purchased on the selected start date and sold on the

## Thoughtful Wealth Planning & Management

is published four times per year by Wealth Planning & Management, LLC, P.O. Box 40994, Indianapolis, IN 46240-0994. All rights reserved. Reproduction in whole or in part is strictly forbidden. News services may quote from this periodical with proper attribution. This issue was completed August 5, 2003. The DJIA was and the S&P 500 was .

Publisher: John W. Guy  
 Editor: Lois Sherman  
 Design: The Art Room

<sup>3</sup> For illustration; not actual values.

# Rate of Return, *continued*

selected end date? Perhaps someone did, but we can't find him. You can't find him. No one can find him. Who purchased stocks in the same proportions as in the index? No one. No comprehensive reality is presented by the numbers in these tables, because no real person or portfolio is demonstrated.

Private investment advisors keep rate of return statistics for individual portfolios and for all managed portfolios combined into a "composite" which is a weighted average. The composite is not a real number because some accounts represented in the composite perform well and others poorly, in different periods, because the accounts have different histories and different philosophical criteria. Mutual funds publish rates of return in a manner similar to calculations applied by investment advisors to individual portfolios. However, mutual fund management companies do not publish a composite rate of return for all funds managed. Mutual fund companies engage in notoriously misleading advertising. Most of their business comes from "the public." "The public" consists of unsolicited online purchasers who naturally gravitate to the best reported rate of return. Therefore, mutual fund companies that manage dozens of different mutual funds advertise only the fund or funds recently having a perceived excellent rate of return. Advertisements do not cite poorly performing funds or a composite of all funds managed. Investment advisors also try to put their best face forward, but their circumstance naturally lends itself to greater candor because results seldom are presented in public advertising. Instead, these advisors present results in private conversations with current and prospective investors. The conversations allow clients to ask detailed

questions and allow advisors to explain the vagaries inherent in any statistic. Some private advisors, however, engage in the highly questionable practice of publishing results of a model portfolio. A model is a hypothetical construction, an academic exercise, not based on the activities of any real person or portfolio. Inevitably, the results of the model are remarkably positive. Otherwise, the advisor would not have published the theoretical result. While footnotes explain that the model does not represent a reality, the caveats have little impact. WP&M views such models as misleading and unethical.

Our firm believes that no performance statistic forms a solid basis for selecting a source of investment advice. Our internal rate of return statistics for accounts

managed confirm the chaotic impression rendered in Tables 1, 2 and 3. We have the same view regarding results presented in real dollars. A real dollar result is seen on individual client statements. It is the account value at the end of each month. These statements can be used to mine data, to see information that supports a predisposition. For example, the owner can look at a one-month comparison, or she can compare this month's value to the same month last year, or she can make any number of other possible comparisons. A tendency obvious to all professional financial advisors is that clients compare the present value to a recent high value (in down markets) rather than comparing today's value to either purchase price

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**Table 1. A Longer Haul**

Quarter Ending	Cumulative* Index Return	Index* Return
03/31/1998		13.53
06/30/1998	16 .84%	2 .91
09/30/1998	4.80%	(10.30)
12/31/1998	26.67%	20.87
03/31/1999	25.37%	4.65
06/30/1999	24.78%	5.06
09/30/1999	17.31%	(5.09)
12/31/1999	23.05%	14.54
03/31/2000	21.32%	2.00
06/30/2000	17.59%	(2.93)
09/30/2000	15.34%	(1.24)
12/31/2000	10.81%	(8.09)
03/31/2001	5.66%	(12.11)
06/30/2001	6.88%	5.52
09/30/2001	1.89%	(14.99)
12/31/2001	4.29%	10.29
03/31/2002	4.02%	(0.06)
06/30/2002	0.46%	(13.66)
09/30/2002	(3.60)%	(17.70)
12/31/2002	(1.94)%	7.92
03/31/2003	(2.53)%	(3.60)
06/30/2003	0.08%	14.89

**Table 2. A Shorter Haul**

Quarter Ending	Cumulative* Index Return	Index* Return
06/30/2002		(13.66)
09/30/2002	(28.94)%	(17.70)
12/31/2002	(23.32)%	7.92
03/31/2003	(26.08)%	(3.60)
06/30/2003	(12.25)%	14.89

**Table 3. A Short Haul**

Quarter Ending	Cumulative* Index Return	Index* Return
12/31/2002		7 .92
03/31/2003	4 .04%	(3 .60)
06/30/2003	19 .53%	14 .89

\* S&P 500 Index. All returns net of fees.

**“I Was Taken,” continued from page 1**

We seem to react this way at home, differently on the road, which is a shame because we travel for fun, not for pain. We have trouble on the road because we are not familiar with the terrain. We naturally feel insecure in another country because on arrival we have no knowledge about the location of services, the general level or prices, the local tipping customs or telephone dialing procedures. We are tired after international travel, and we need time both to rest and to acclimate to the temperature and humidity, to different foods, and to water having a different taste and composition. The sales practices in many nations are different than ours. Mobile vendors and sales personnel in public markets are aggressive. They push and insist. While at home we purchase voluntarily by

withdrawing items from a standing display. In other nations vendors come close, and they hang around a while, producing in us a distinct discomfort. At home, price tags provide a basis for decision. On the road, we get a feeling that the quoted price changes, that the price is higher for Americans, and subject to negotiation.<sup>2</sup> The “in your face” approach is tough to handle. The memory of having paid a relatively high price to an aggressive vendor is especially galling

The purchasing mistakes we make during international trips are not un-

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<sup>2</sup>Inflation in some countries periodically has made price tagging impossible.

like the mistakes we make every day in all aspects of life. When we laugh at mistakes made at home, when we laugh at mistakes made abroad, when we enjoy and appreciate cultural differences, and when we understand that all sales personnel need to earn income according to the standards of their economies, all is well. When we remember how much we enjoyed that slice of watermelon on the corner, or the bananas or fresh bread delivered to our boat, frustration about price changes to appreciation for service rendered.

**Rate of Return,  
continued from page 3**

or to values obtained by other investors. In the past ten years, custodians have started to present statements with longer term data, purchase prices, unrealized gains and losses, and with comparisons to indexes—helpful improvements that provide perspective.

If rate-of-return information is chaotic and subject to data mining, what is a better way to evaluate and to measure investment advisors? The best criteria are philosophy, trading history, types of investments owned, such as blue chip or speculative, diversification standards, personal experience and professional achievement, and willingness to communicate in writing. WP&M hopes that clients and prospects read our newsletters and quarterly reports which, as a group, communicate our way of thinking. If our way is your way, come see us.

**Final Thought**

**P**aying fees to financial institutions and to personal financial advisors is like paying tax to support the local fire station. Like homeowners near the fire station, investors experience comfort knowing that someone is watching and is there to help. In the unlikely event of a crisis, the fire truck arrives quickly and brings people and resources. In times of personal stress and sudden change, financial institutions and advisors apply professional skills and perspective to reduce negative effects and to help people plan for a stable future.

*Good night, Dorothy. You done good.*

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