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## The Big Bad Bucks

Conseco keeps popping back on the radar screen. Is the target bright, or is the screen set to receive data about only this Indianapolis company? Does the company act as foolishly as it appears, or is the fool watching? This moral doubt lingers in any discussion. Is the other fellow the jerk, or am I the jerk for having misunderstood? The accurate statement is:

I do not comprehend why Conseco might pay almost \$20 million to its new "non-executive" chairman of the board over the next two years. Why is he worth it? Why does he need it? Why does he want it? What is wrong with this man? What is wrong with a board that acquiesces to such frivolity? Why doesn't somebody explain? Why doesn't the board give us its reasoning? Why doesn't the new guy explain, candidly, directly, forcefully: "I am worth \$20 million because I will save this company and increase its market value by billions?" Politicians promise. Why can't he?

Conseco became bankrupt under highly paid leadership. During the period 1997 to 2000, then-leader Steven Hilbert and 11 other top officers received salaries and benefits valued at more than \$700 million.<sup>1</sup> In June of 2000 the company paid a \$45 million signing bonus to Hilbert's successor, Gary Wendt, followed by an \$8 million bonus in June, 2002. Wendt's

job was to save the company. In December of that year, Conseco filed for Chapter 11 bankruptcy protection. The company lost, but Wendt won, like in a bullfight. Whether the matador succeeds or fails, the bull bites the dust, and the matador is treated like a hero. Come on Gary (and others). Give the money back. You did not earn it.

The \$20 million pay package is for R. Glenn Hilliard, age 60, retired CEO of ING Americas. He has a relatively new role in corporate governance. He is chairman of the board without day-to-day executive authority or responsibility. He is supposed to consult with the chief executive officer, Bill Shea, on whose shoulders day-to-day problems rest. He also is supposed to "organize" the board of directors, whatever that means. Both Hilliard and Shea are widely respected. Both have the experience and reputations for integrity. These reputations are supposed to help improve both the real business and the image of Conseco.<sup>2</sup> Yet, if these guys are so good, why don't they work for a reasonable amount now on a promise of bonuses if the company turns around and again becomes a respected member of the business community? So far, the highest paid people, Hilbert and Wendt, did nothing to improve the situation, and no one has proved a valid correlation between executive pay and company

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<sup>1</sup> Information from the *Indianapolis Business Journal*

<sup>2</sup> Conseco probably will change its name, a common occurrence among companies having a poor history.

## The Big Bad Bucks, *continued from page 1*

performance. No one has proved that past success leads to future fortune. A whole lot of people are one-timers. The builder of the Suez Canal made lots of money for French investors, then lost everything trying to build the Panama Canal. Michael Jordon is a great person, but that body does not fly like it used to. Mark Twain failed financially in his last ten years. All of Einstein's significant work took place before his fourth decade. And what has Bill Gates done recently?

People establish reputations for success while young, then botch things while old. No example is more telling than Steve Hilbert himself. Building on skills learned as a successful encyclopedia and insurance salesman, he and a partner started Conseco in 1979 when Steve was 33 years old. Though not stated specifically in his *Indianapolis Star* biography, my recollection is that he obtained original capital through a door-to-door sale of common stock, followed several years later by additional sales of stock through investment bankers. The original idea was sound. He believed, and later proved, that acquiring several small insurance

companies and then combining operations would result in cost savings and higher profits. As he changed from a "young and restless" to an "older and more ambitious," his vision changed from creating operating efficiency to becoming big and powerful. Indicative of future problems was his attempt to acquire an insurance company many times the size of Conseco. The attempt failed, probably then a good thing for Conseco, because his last big acquisition, Greentree Financial, brought ruin at the new millennium when he was approaching 55 years old. What followed was one of the largest bankruptcies in U.S. economic history, with dead bodies everywhere. If only he had stuck to his original vision! The company would have been smaller, but alive and well.

With few exceptions, I believe that the most successful executive careers are people who make big marks while young, then preserve their successes as life proceeds. They preserve success either by maintaining a conservative posture as a chief executive or chairman of the board, or by placing themselves in a position to provide advice and counsel to new executives moving up. This pattern works in basic industries such as energy and financial services. Usually, we never are aware of the names of these executives, but their employees and colleagues respect them for their original innovative work and for their later efforts to conserve. As a result of the first success, they usually do not need money. What do you do with an extra \$10 million a year? How many houses can you own?<sup>3</sup> Will the money wind up in the hands of a second generation? Let's not consider the poor record of second-generation wealth in managing money.

At the new Conseco, Shea is in his fifties, and Hilliard in his sixties, the points

<sup>3</sup> If a highly paid CEO gives 50 percent to charity, should we change our point of view?

in life where most people are inclined to conserve and to preserve. Perhaps they have the appropriate leadership attitudes and skills for preserving and rebuilding Conseco. Hopefully, they will be successful. If so, their rewards should come at the conclusion of service, not in advance. Personally, though, I would prefer to see Conseco led by a forty-year-old who has intelligence and a sound vision, who would receive more compensation from Conseco if his vision were successful. Therefore, I say to Mr. Hilliard: Be reasonable. The company needs the money more than you do. Give it back.<sup>4</sup>

## A Note About Compensation

As mentioned above, one source calculated that executive compensation at Conseco was \$700 million during the period 1997 to 2000. The source did not state what portion of this amount was paid in stock, stock options, or other stock-related securities. Unless recipients sold those securities at opportune moments, values must have disappeared in the bankruptcy. Nevertheless, the cash portions of compensation were sufficient for the individuals to maintain handsome life styles.

<sup>4</sup> One Indianapolis chief executive turned down a bonus package about ten years ago. He is respected for founding a company, contributing to his community, and being a nice person. On the other hand, I never have seen a grave stone saying, "He earned \$10 million a year." At some point, no one cares what is earned. Character and achievement are more important.

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## HAVE YOU EVER WONDERED WHETHER . . .

. . . information can be used to make more productive investment decisions, or whether data or news is “noise” that cannot be processed into useful decisions?

Or, can a consensus of estimates of next year’s earnings growth rate be used to reap extraordinary profits?

Or, which has a better chance of success: the investor who knows a lot about two stocks, or the investor who knows a little about 100 stocks?

These and more than 41 other questions are answered in the new book *Investment Management, Portfolio Diversification, Risk, and Timing—Fact and Fiction* in which author Robert L. Hagins challenges and buries many of the most widely held basic beliefs of investors.<sup>5</sup>

Hagins’ premise is that our problem as investors is what we know, or what we believe to be self-evident truths. Our problem is not ignorance, because

acknowledgement of ignorance usually sets off a search for correct information. On the other hand, if we think that we know something for sure, we drive toward trouble. For example, most observers believe that Reno is east of Los Angeles and that Rome is on the same latitude with Atlanta, both incorrect. Most people believe that automobile accidents kill more people annually than heart disease, but, in fact, heart disease wins the death race ten to one. Misconception abounds in real life and in investing. Hagins wants to correct misconceptions, believing that the result will be better investors. So, he asks questions:

Do male investors trade more frequently than female investors? Do stocks sold by investors under-perform stocks purchased? What is the average number of stocks held by individual investors served by one large discount brokerage firm? Are investors more likely to sell their winners or their losers? Is it reasonable to expect that revisions

in analysts’ earnings forecasts can be used to obtain above-benchmark returns? What correlation exists between current price earnings ratios and forecasted price earnings ratios? Can analysts, on average, correctly forecast changes in next year’s earnings? What about “Torpedo” stocks?

Most of Hagins’ questions are answered with statistics, such as by mathematical probabilities, because, according to him, quantitative answers provide greater understanding. “If you know a thing only qualitatively, you know it no more than vaguely,” he states. “If you know it quantitatively—grasping some numerical measure that distinguishes it from an infinite number of other possibilities—you are beginning to know it deeply. You comprehend some of its beauty and you gain access to its power and to the understanding it provides.” His book helps us to comprehend the beauty, power—and risks—of stock market commitments.

<sup>5</sup> John Wiley & Sons, 2004

## Random Thoughts from an Otherwise Empty Mind, Including Questions for Readers

What is a beguine? How does one begin a beguine? (Answers graciously accepted at [john@wpam.com](mailto:john@wpam.com).)

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Imagine a long back-up on Interstate 70, between Indianapolis and Richmond, caused by construction. First, imagine the cars move forward at a constant speed bumper to bumper. Then, imagine the cars moving forward at the same speed with two car lengths between each car. Question: Will the last car in line arrive at its destination later in the second scenario than in the first?

Why?

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I have seen mussels on menus, but never cockles. What is a cockle? Could it be “alive alive o?”

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Solitaire players experience arrays in which all cards initially turned in the seven piles are one color and all cards revealed during the three-card flip are the same color. How can this be if half the cards in the deck are the other color?

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Modern investment theorists apply scientific and mathematical principles to investment activities.

Hence, chaos theory, probability theory, mathematical concepts such as standard deviation, and equations resulting in various ratios and equations all find their way into investment literature.

Robert Hagins, author of the book mentioned earlier in this letter, relies almost entirely on scientific or mathematical ideas to make his points. His concluding concept that a thing can

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## A FINAL FICTION

A recent revisit to the work of John LeCarré pleasantly reignited an understanding that business organizations, investment networks, and spy networks seem always beholden to the being called human.

In *The Perfect Spy* we see a man with three fathers: the real father, a mentor from “the other side” who helped to form the young personality while he studied in Germany, and the Englishman who supported his life at home. With no sense of moral judgment, and with compelling loyalties to both surrogates, sensitive information passes in one direction, then in the other. The death of the real father prompts emotional release from all three, and a predictable end. The reader is left with an understanding that spying is a zero-sum game, not unlike some investment strategies.

*The Tailor of Panama* is another Englishman, trained on Saville Row, who provides suits to the political leaders of his adopted country.

Coincidentally, the British Secret Service finds no better assignment for a failed incompetent spy than to dig up important information in Panama. When the spy meets the tailor, sparks fly, money changes hands, and any sense of proportion is abandoned. The spy needs a source, the tailor needs money to avoid financial failure, and London loves information, but what does the source do when all has been told, when the spy (and London) know everything? The money stops. Right? Not necessarily, for fiction commands the same price as fact. The reader is left with an understanding that spying is an absurd game and that truth is not always the highest value. A plausible story is worth as much in a spy market as in a stock market.

In *Russia House* a vast but temporary alliance is built between Whitehall and Langley, stimulated entirely by a fed-up Russian scientist who believes world peace will be assured when the United States realizes that Russian weapons system

are weak and worthless. To make the point, he asks his lover to pass on sophisticated drawings and equations, the documented proof of uselessness. On receipt, the institutional mouths of the two services salivate. This is hot stuff. The ins and outs of moving information make a readable plot in part because three key players are amateurs. Of equal interest is the futility of it all because this is the time of *glasnost*, those years in which Americans realized that Russia was a weak competitor and Russians realized that the west genuinely did not want to attack. Hence, the information provided was not worth the effort. We had it anyway. Again, the reader concludes that spying is a bit silly, that decisions and networks are controlled by personalities meeting in committee, by persons trying to make retirement, avoid blame, or achieve promotion. Is this also the dynamic of corporations? Of investment committees? Tell us, Dilbert. It would be fun to know. And thank you, John, for making your points with real people, real places, and real prose.

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### Random Thoughts, *continued from page 3*

be known thoroughly only by precise quantification is drawn directly from the words of scientist Carl Sagan.

Scientists work with phenomena having a high degree of certainty, such as gravity. These phenomena are born or are part of the natural world. Investing is not part of the natural world. Every element of investing is man-made. Currencies, stocks, bonds,

options, certificates of deposit, and all forms of corporate organization, related laws, and concepts of trust, were made by human beings trying to capture value and to concentrate the wealth of many onto a limited number of projects. So, the question:

Is it appropriate, or futile, to apply the ideas of natural science to the social science of investing?

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*Good night, Dorothy. You done good.*

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