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BOOK REVIEW

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DEBUNKERY: LEARN IT, DO IT, AND PROFIT FROM IT—Seeing Through Wall Street's Money-Killing Myths

By Ken Fisher and Lara Hoffman
(*Reviewed by Bruce Grantier*)

This book is about commonly held but mistaken beliefs, hence its title and objective—to debunk these myths. It does so convincingly, with logical arguments supported by extensive data.

The author, Ken Fisher is founder, Chairman, and CEO of Fisher Investments. He is well known as a 26-year contributor to the *Forbes* magazine's "Portfolio Strategy" column. This book is his seventh. I have read two—"The Only Three Questions That Count" and "The Wall Street Waltz"—both of which are worth reading (Fisher, 2007, 2009). "Three Questions" is more of an intellectual or philosophical discussion while "Waltz" presents 90 visual perspectives on economic and investment topics, many of which are based on very long term data. "Debunkery" contains historical data and arguments on 50 common myths and, in a way, builds on the other two publications. Ken Fisher has published in investment journals and periodicals, for example, he co-authored with Meir Statman "Cognitive Biases in Market Forecasting" (Fisher, Fall 2000). The book is part of a series published by Wiley entitled Fisher Investment Press.

Ken Fisher very generously spent some time with me discussing the book in detail and I am very grateful to him. I was struck with how passionate he is about the various concepts on which he writes and came away with the realization of how little one really questions some of our long-standing beliefs.

There are the five sections—grouping the 50 myths into similar categories.

For example, "History Lessons" is mainly macroeconomic relationships and "It's a Great Big World" is mainly about global investing. I have shown below in italics the five sections and within those, selected topics of particular interest. All data, unless indicated otherwise is for US stocks and bonds.

Section 1. Basic Bunk (the biggest investment myths)

These selected topics from this section all have significant implications for defined contribution (DC) pension plans—an important area for both

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plan sponsors and individuals alike.

- *Bonds are Safer Than Stocks*: using rolling three-year periods from 1925 to 2009, bonds have more negative periods than stocks. Of course you can argue that the swings in stock returns are larger, but then stock returns are much higher than bond returns—especially in real terms, which is critical for retirees.
- *Well-Rested Investors are Better Investors*: over 30 year rolling periods since 1925 (54 periods) stocks beat bonds in all periods. Over 20 year rolling periods, stocks beat bonds in 62 out of 64 periods. While the qualitative asset class return comparisons are well known—see, for example, Jeremy Siegel's "Stocks for the Long Run" (Siegel, 2002), Fisher discusses quantitative aspects of these returns, which are not so often quoted. Over 30 year periods, stock returns are 4.8 times better than bonds. Over 20 year periods, stock returns are 3.7 times better. Also for the 20 year periods, in the 2 out of 64 periods when bonds beat stocks, the bond returns were only 1.1 times better than stocks—nothing for the cost of forgoing the much better stock returns in the other 62 periods.
- *Retirees Must Be Conservative*: again, the data and comments are not unique. But Fisher's comments on longevity are very important to DC plans and their widespread use of target-date retirement funds. Recent IRS actuarial assumptions give today's average 65-year-old retiree a life expectancy of 20 more years (30 if that person is in the top 25% of retirees). This is due to better fitness, activity, nutrition, technology, and innovation—trends which will likely persist. The chapter contains the details of the outperformance of stocks over bonds in frequency and magnitude for 1, 2, 3, 4, 5, 10, 15, 20, and 30 year periods.
- *Age Equals Asset Allocation*: continuing on this line of thought, age alone is not an adequate determinant of asset allocation—as in "100 less age" suggests the percentage one should have in stocks. Fisher notes the broader determinants of asset mix should include: time horizon, return expectations, and cash flow needs.
- *You Should Expect Average Returns*: the reality is, normal returns are extreme. Using the same data range (1925–2009), frequency of annual returns is: less than 0–29% of the time, 0–33% of the time, over 20–38% of the time. Further, while annual returns below than −30% occurred only 4% of the time, returns above +30% occurred 21% of the time (on average 1 in 5 years). Smooth returns don't exist except in non-equity asset classes. To earn equity-like returns requires accepting downside volatility. This sounds obvious, but is a necessary accompaniment of the argument for equities for DC plan sponsors and investors with life expectancies over 20 years.

Section 2. Wall Street Wisdom (as the title sounds)

- *Beta Measures Risk*: beta is the well known coefficient from the Capital Asset Pricing Model, relating the volatility of the stock to the overall market. In CAPM, Beta is often interpreted as a measure of risk. Ken Fisher has some very good company in debunking beta's role as a measure of risk (Montier, 2007). His views that beta is only a measure of past risk are consistent with Fama and French in that betas are unstable (high-beta growth stocks disappoint and become low-beta value stocks, etc.) Hence value stocks have outperformed growth stocks over the long term (Fama and French, May–June 2007,

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Nov.–Dec. 2007). His views are also consistent with the value investors' views that volatility is your friend in that it presents opportunities—illustrating this with both US and World stocks six months pre and post March 9, 2009.

- *Equity Risk Premiums—Forecasting Future Returns With Ease*: Equity Risk Premiums (ERPs) are too variable to be useful in forecasting although are often taken quite seriously. The chapter noted earlier about average returns should convince one of this, but in case not, Fisher shows the eight ERPs by decade from 1930 to 2010 using stocks vs. 10-year treasuries. The average has been 4.4%, while the range was −7.6% (that is −7.6% p.a. for 10 years) to 18.9%. Statistically 80 year ERP has been 4.4% per annum, however with an extremely wide range—a range well worth thinking about when using the ERP.

Section 3. *Everyone Knows* (conventional wisdom)

- *Don't Fight the Fed*: this myth is one of the more popular and also misguided one. It falls within a category of myths which hold out that any single indicator works consistently in explaining equity market returns. Fisher shows the results of US and MSCI World returns after 12, 24, and 36 months post the commencement of nine sustained tightening cycles since 1970 to date. The results show positive equity returns for most periods—typically 7–8 out of the 9 tightening cycles produced very respectable equity returns for both US and World. For example, 36 months after the start of Fed tightening, in the US, stocks on average returned 31%, while MSCI World stocks returned 33%.
- *Baby Boomers Retire, World Ends, Etc.*: this myth stems from the belief that the 78 million retiring US boomers will sell stocks to raise cash or switch to bonds, compounded by the pending shortfall Social Security benefits in the face of the demographic bulge of retirees. Arguments against this include: boomers have a long time horizon, the boomer bubble moves at a glacial rate, and ultimately, all this is well discounted by equity markets. Further, the massive accumulated wealth of boomers continues to accumulate over the coming decades and much of it will probably be passed on rather than spent. Regarding Social Security, while it is true the bulge in retirees does put an additional strain on Social Security payments, the fear of "bankruptcy" is simply not justified as the system is not funded but has always been "pay as you go".

Section 4. *History Lessons* (macroeconomic relationships)

- *Pray for Budget Surpluses*: the evidence in this chapter is convincing. Government surpluses and deficits as a % of GDP are tracked from 1947 through 2009. Peaks and troughs are indentified and the ensuing 12, 24, and 36 equity market returns are calculated. The myth is soundly dispelled when it turns out the average 12, 24, and 36 months equity returns following deficit peaks are resoundingly better than those following surplus peaks. The reason, Fisher points out, is simply the stimulative effect on consumer and business of government deficits, and the opposite effect of surpluses.
- *High Unemployment is a Killer*: the reality is unemployment lags the stock market—by a lot usually. The lead of stocks is illustrated in data from 1929 through 2009. Twelve month stock returns measured from 6 months prior to peaks in

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unemployment are twice as good as twelve month stock returns measured from the actual peak in unemployment.

- *Stocks Love Lower Taxes*: a review of four periods in which there were tax changes, reveals there are no clear correlations between marginal shifts in tax rates and subsequent stock returns. Fisher discusses the periods: the Economic Recovery Act of 1981, the Tax reform Act of 1986, the Taxpayer Relief Act of 1997, and the Jobs and Growth Tax Relief Reconciliation Act of 2003. Reasons, he posits, include the efficient discounting of tax changes, which are a long time in the making, plus the fact that about half of US equity holdings are exempt from taxes.
- *Consumers are King*: this myth is probably well-known to anyone with an economic education, but is still worth noting as the media endlessly proclaims the US consumers' demise. The facts are, while consumer spending is currently about 71% of US GDP, 68% of consumer spending is on services, which are very stable. The durable goods sector, it is true, suffers during recessions. However this sector is about 10% of GDP and only half the size of non-durable goods spending, which—like services—tends to be fairly stable as well. The sector which accounts for the biggest swings in GDP is business investment spending including inventory adjustment.
- *Presidential Term Cycles*: this topic is not exactly a macroeconomic relationship, but is well-worth noting as the data is so instructive. Going back 22 presidential terms starting with Coolidge in 1925, the performance of equity markets in first terms is quite volatile, much more than in second terms. Also second terms on average have had much better returns than first terms. Again, this chapter's data is well worth the read.

Section 5. It's a Great Big World (global investing)

- *Who Needs Foreign?*: this chapter addresses the long-term returns of EAFE and the S&P 500 and is well known, but still worth the mention and presented in a good way. Over 1970–2009, US stocks have returned 10.0% annualized vs. 9.4% for EAFE (total return). The leadership has traded between the two irregularly and for irregular periods—at times fairly long. However owning both stabilizes returns, and, while not trying to time between the two, either may opportunistically offer better value at times.
- *Big Debt is National Debt*: this chapter compares US and UK public debt to GDP and makes the point that UK debt to GDP has been very much higher than the US in the past. The chapter reminds one of "This Time is Different: Eight Centuries of Financial Follies (Reinhart and Rogoff, 2009)" (reviewed here last year) in that it advocates a broad and long-term perspective in assessing today's debt concerns.
- *America Can't Handle Its Debt*: this brief chapter offers a good perspective on US Federal debt over time and in the global context. It shows Federal interest payments as a % of GDP from 1952 to 2009. Despite the large increases in debt, lower interest rates have offset almost entirely, leaving Federal interest payments surprisingly only slightly higher than the historic levels and much lower than the 1980s and 1990s. Since global interest rates have tended to move in unison, any rise in rate would affect other countries similarly.
- *Indebted to China*: US Government debt held by China has been viewed as a concern, should China decide

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to reduce its holdings. The chapter shows China holding 7.3% of US Treasury debt at the end of 2009, small compared to the 36.6% held by US Federal agencies, 27.7% held by US investors, 5.7% held by public pension plan and state governments, and 22.7% by the rest of the world. Japan (currently holding slightly less than China) has over the past few years held more than China.

- *Trade Deficits Make Deficient Markets*: this chapter compares trade balances with equity market performance over 1980–2009. The US and the UK have had deteriorations in their trade balances and run deficits over this period—while producing equity returns in the order of 10–11%. Japan and Germany have run surpluses over the same period yet have produced lower equity returns in the order of 7–9%.

Overall, the book is well-researched, convincingly and intelligently written, and thoroughly enjoyable to read. I would enthusiastically recommend it. I hope this brief summary of debunked myths serves to pique the reader's interest and challenge, as it did my own, one's understanding of commonly held beliefs.

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