How not to be chumped by Wall Street

This is a review of a chapter of a book by Bill Bonner and Lila Rajiva called *"Mobs, Messiahs, and Markets."* That chapter is **'How not to be chumped by Wall Street.'**

Remember the Clint Eastwood saying from Dirty Harry? *'You gotta ask yourself one question . . . do you feel lucky? Well, do ya, punk?'*

The market rally of the late 1990's has led most people to believe that they could get rich without working. People had gotten so lucky they thought they would never need to save again. Were they investing or gambling to reach a financially secure future?

Money may make the world go around, but in matters of money, as in other things, the whirl of the public spectacle tends to make a man's head spin just as fast. Whether he is getting money or getting rid of it, he is rarely far from mass sentiments, and never far from calamity. In getting money, he is lured toward destruction by the markets, by commentators and economists, by the headlines, and by the financial industry itself. In spending, he has a whole world of entrepreneurs and businessmen ready to help separate him from it.

The central message of this book is how to avoid getting caught up in the public spectacle of money.

The naïve scientist looks at the stock market and figures it must follow some pattern. Prices go up, and then they go down. When? How? Why? He studies the situation and proposes a trading hypothesis: "I will only buy stocks that have gone up for the last three months" or "I will follow the stochastics." And so, he sets out to invest rationally and logically . . . often until all his money is gone.

Experts say 90 percent of traders eventually lose their money. We are amazed; we thought the number would be closer to 100 percent.

But aren't markets fundamentally logical? Isn't it all a matter of numbers? Doesn't a rational approach to investing pay off? Unfortunately NO.

As far as anyone knows, markets are unpredictable. And if anyone knows anything to the contrary, he is keeping quiet about it, because as soon as other investors caught on, the secret would be rendered useless.

Markets are infinitely complex systems. They are chaotic systems, say the mathematicians, subject to feedback loops from their constituent parts. After prices have been pushed up by too much investor interest – investors seem to get worn out and prices fall.

The first question to ask yourself is: What do you really want? "More money," comes the typical answer. It is a reasonable one, but we are suspicious of it. People's

relationship with money is formed not by what they *say* they want, but what they actually *do* want – or what they actually deserve.

The vast majority of wealth is made the old fashion way, by accumulation. Thrift used to be a virtue, now it is a mystery. Getting rich was no mystery. You looked at two numbers. One was revenue and the other was expense. It was just a matter of degree; the larger the spread between the former and the latter, the richer you became. People typically tried to spend less than they made. The difference was savings for the family, and the greater the savings, generally, the richer the family.

Going back, we ask 'why are you doing it?" (investing in the market) Most people respond automatically, "To make money." Interesting enough most people do not really invest to make money, they invest because they don't know what else to do with it, or they invest to achieve other goals, like status respectability, and security. They invest in what is trendy . . . or popular . . . or socially acceptable. That way no one can fault them for doing something reckless with the family fortune; they put it in mutual funds, just like everyone else.

But what you gain in stature today may be lost in dollars tomorrow, for there is likely to come a time when you will have to do some explaining. That is an important consideration for many people. Some crave their returns – in whatever form – right now, rather than in the future. If an investment would pay off – even handsomely – in 5, 10, or 20 years, they wouldn't be interested.

There is no right way to invest. There are a lot of different ways, almost any of which can make money. On the one hand, a method that works spectacularly in one period may not in another. Why is this so? Investing is, when you get down to the gritty basement of it, a competitive undertaking. If you do what everyone else does, you will get the same returns as everyone else. In order to get better returns, you have to do things differently. Investors who follow newsletters gurus have no guarantee of making money; but those who follow the crowd are practically guaranteed that they will not.

If an investor merely recognizes the way mob sentiments works, he is far ahead of most punters. Most people put their faith in experts and their money in mutual funds, and they get their opinions from the headlines. But if he can tune out the noise of the public spectacle altogether, an investor has a chance of at least keeping his dignity . . . and maybe even his money.

Ordinary people turn over billions of dollars' worth of their hard-earned money – immediate, tangible, personal money – believing that strangers will give them back even more. A plumber is supposed to have about as much chance of winning at stock speculation as a corporate insider, they believe.

Of course, it is a monumental fraud – almost equal to "every vote counts" or the "divine right of kings." The market is supposed to be a level playing field, with all the players having an equal chance to kick the ball. The little guy is supposed to be as likely to make money as the big guy.

In theory it works perfectly; in practice, the little guys lose consistently. They lose in two ways: First, they pay out too much to the financial industry in fees, commissions and spreads. And second, they lose money because they become patsies of the public spectacle. They read newspapers. They watch TV. They listen to experts, the commentators, the pundits. As a consequence, they are buyers to whom the elite sells. They are the sellers from whom the elite buys. Without the amateurs, investing wouldn't be nearly as rewarding for the pros.

The whole idea is preposterous. But every public spectacle needs its myths. And the myth of an efficient market keeps the chumps at the investing tables. They think they have as much chance of making money as Goldman traders, they believe, because – no matter how much they pay – it can't be too much.

How do you calculate the risks? Most people don't even try. They do not bother to figure out the likely return on investments or the real risk. They just go along with the crowd of yahoos – with some cockamamie notion in their heads, such as 'stocks for the long run.'

"But the professionals get a better rate of return," you might protest. "So it's worth paying a little bit in commissions." Is that so? A recent Bloomberg study of 350 of the top brokerage houses – companies that had the brightest employees, with the plumiest salaries, the nattiest suits, and the slickest educations – found something extraordinary. The very best of them, Merrill Lynch, got it right only 34% of the time. Merrill picked 200 stocks, of which only 68 turned out to be winners. These are full time professional analysts, earning an average of about $600,000 per year.

The authors believe that the next bull market run in stocks may not come until the year 2040. They agree that they have no way of knowing, but feel if the patterns of the past repeat themselves, this might be close.

Maybe it is time to start thinking for your self instead of following the crowd. Give us a call and we can discuss the alternatives.

Dan M. Maga & Dan M. Maga II
American College Funding
Maga Financial Associates
444 Skokie Blvd – Suite 302
Wilmette, IL 60091
8470920-9680
www.americancollegefunding.net
www.magafinancial.com