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Financial Porn Can Seriously Distract

Don't let it harm your long-term goals

By Jonathan Chevreau
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I have a confession to make. I'm a pornographer. And you, dear reader, are a consumer of racy, salacious material.

Wait! It's not what you think. We're talking about financial pornography, not the other kind.

Financial pornography is a term coined by American personal finance writer Jane Bryant Quinn. It refers to the tendency of the mass media to excite its readers about short-term fluctuations in the market—or other trends which if acted upon precipitously could harm your long-term financial health.

Even in the daily media, you don't have to look far to find examples of financial titillation. The stock market plummets and the headlines warn of economic armageddon. Or oil prices soar and another headline urges us to jump into energy mutual funds.

We and our competitors get our readers all hot and bothered about individual stocks—RIM soars, Nortel plummets—or hot new sector trends, commodities being the latest.

Our cousins in the magazine business are equally guilty, with their cover stories on the "7 mutual funds you must own now."

Financial pornography is far more pervasive than it used to be. At one point financial news was found only in an obscure part of the paper called the business section. Rarely did business stories hit the front pages.

It was rarer still to see business news on television—until all-news channels arrived, followed by CNBC and its all-business-all-the-time imitators. The rise of financial TV channels corresponded with the meteoric growth of the mutual fund industry in the 1990s and the bull market.

Financial books also feed this craze, with celebrity author-gurus providing even more fodder for the daily press.

If this weren't enough, along came talk radio, with regular stock market updates every 10 minutes, and finally the coup de grâce: the Internet, which allows every financial pundit with a mouse and keyboard to enter the fray.

You know the outcome. The constant noise and breathless bookspredicting the Dow Jones Industrial Average would hit 36,000 or even 100,000 got the public infatuated with technology stocks or sci/tech funds at precisely the worst time. Financial pornographers succeeded in sucking in the most tech investors right at the top of the bubble in 1999-2000.

Little wonder that financial advisors believe one of their roles is to help investors "stay the course" by ignoring the press. Last week, a conference for advisors sponsored by DFA Canada Inc., an index fund company, featured a briefing session on this phenomenon.

In a presentation entitled *The Big Tease: How the Financial Press Tickles Our Prurient Financial Interest,* DFA vice-president Weston Wellington took advisors through a veritable rogue's gallery of magazine cover stories, sensational newspaper headlines and other sordid examples of financial pornography.

Wellington highlighted three successive annual issues of Smart Money magazine, beginning in 1996 with its "7 Best Mutual Funds" cover story. If you rushed out to buy all seven, you would have lost 6.7% that year. In 1997, it chose seven brand new funds, which then sank 3.4%. In 1998, it picked just six funds, resulting in a marginal improvement: the six funds together lost only 2.2%.[1]

In 1999, an anonymous Fortune writer spilled the beans when he/she wrote "Confessions of a former mutual funds reporter." "By day we write 'Six Funds to Buy NOW!' By night, we invest in sensible index funds." (You can find it archived at www.bylo.org.)

The Morningstar fund rating service fared little better, with its model portfolios lagging the Vanguard Total Stock Market Index from inception to Sept. 30, 2004, according to DFA.[2]

But that was nothing compared to the individual stock picks of analyst gurus featured in a 2000 issue of Fortune. Each "all-star analyst" sported a blue jacket, with the cover headline blaring "Let them make you rich."

Oh yeah? If you bought Oracle at its then-price of US$72 because of the star analyst's "target" price of US$115, you saw the stock plummet to US$13.23 by the end of 2003.

Worldcom was deemed "dirt cheap" at US$45 but had become even dirtier and cheaper by the time it went into Chapter 11 bankruptcy protection in July, 2002. In 2001, the Average All-star stock return was minus 17%, compared to just minus 9% for the S&P500.

The media are just as apt to knock investors off course with big-picture "the rules have changed" pieces.

The famous Aug. 13, 1979, Business Week cover proclaiming "The death of equities" remains the most egregious—if over-cited—example. But there have been many comparable calls pushing a particular geographical region or economic sector as the new big thing into which investors should jump.

China is the latest hot spot but Wellington cited gushing cover stories on the pre-eminence of Japan in 1989, just before the country sank into a decade-long deflation. By 2002, the Economist was bemoaning "the sadness of Japan" on its cover.

In the media's defence, singling out such examples is a bit unfair, since hindsight is always 20/20. Going forward, investors should ask themselves what practical use this insight into the press can be.

Even knowing all this, I personally continue to read the financial press. If you have a balanced diversified portfolio, you can read about plummeting individual stocks and spectacular runups with relative equanimity. You may not go as far as financial writer Jason Zweig's rallying cry of "I don't know and I don't care" but you'll certainly be better equipped to listen to your advisor and stay the course.

Zweig and the Wall Street Journal's Jonathan Clements were both cited by Wellington as rare exceptions to the general trend to serving up financial pornography.

In the end, the media offers a bizarre mix of information and entertainment. As a serious investor, you must learn how to separate the wheat from the chaff; once you learn to do so, you can make a game of spotting the latest example of financial pornography. This column will try to avoid being part of your growing collection.

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[1] Relative to the total return of the CRSP US Equity Universe, the mutual funds identifi ed by SmartMoney in their

"Best Mutual Funds" series underperformed, on average, by 6.7% in 1996, 3.4% in 1997, and 2.2% in 1998.

[2] According to an analysis appearing in Morningstar FundInvestor, Morningstar balanced model portfolios have, since inception, underperformed a benchmark consisting of Vanguard Total Stock Market Index Fund, Vanguard Total International Stock Market Index Fund, and Vanguard Total Bond Market Index Fund.

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