

Mythbusters: Stamping out bad investment advice

As far as I know, humans are the only animals capable of self-delusion.

We hear a statement that sounds good or makes sense, and we want to believe it, even if no facts back up the words. The more people make that statement, the tougher it is to resist. And thus myths and legends form.

Plenty of investing myths have cropped up over the decades. Some stay with us because they sound like good advice, while others play on our fears. If you can't always tell a myth from a truth at first hearing, you're not alone.

Today I'm going to debunk four myths using weapons available to any investor — logic and hard numbers.

Myth 1: Older investors shouldn't own stocks

Add a word to the statement — such as, “older investors shouldn't own *only* stocks” — and you've moved from myth to truth.

I can't tell you what percentage of your assets to invest in equities because every situation is different. But here are a few facts to consider:

- Unless your portfolio already generates sufficient income to support you for life, you'll want some securities with more growth potential than bonds.
- If you intend to pass on your wealth to your family or charities after you die, it's wise to keep building it.
- Even portfolios containing a small percentage of stocks tend to outperform those with only bonds.

The first two points attack the myth via logic, while the last point brings numbers to bear.

Based on returns from 1926 through 2014, adding stocks to bond portfolios boosted performance, a fact that shouldn't surprise you. However, portfolios that blended stocks and bonds delivered superior risk-adjusted returns, as measured by average annual return divided by the standard deviation of those returns. Standard deviation is a measure of volatility.

Truth: Most investors, regardless of their age or goals, should own both stocks and bonds.

Myth 2: Everyone should own gold

Before getting started on gold, I must say that over the years many subscribers have come to the conclusion that the *Forecasts* hates the precious metal, mostly because we don't recommend going to gold when the market gets rough.

We don't hate gold; we just don't expect it to provide returns competitive with stocks. For what it is — an inflation hedge and diversification tool — gold works well.

Like most hard assets, gold's returns are minimally correlated with those of stocks and bonds, and the metal can hold value when financial assets suffer, as evidenced by its outperforming the S&P 500 index in 10 of the 12 years from 2000 through 2011. In addition, gold is perceived to always have value, while stocks and bonds can dwindle to nothing.

However, today we're taking the long view, and history suggests gold won't beat stocks over long periods. In 1980, gold traded at \$615 per ounce. In 2007, 28 years later, it traded at ... \$695 per ounce, up 13%, or a whopping 0.4% annualized. Over that same 28 years, the S&P 500 rose 982%, or 8.9% annualized.

Since 1968, when the U.S. government stopped setting gold prices, gold has tended to plateau for several years, then jump aggressively. That pattern has played out three times, including the plateau that lasted throughout the 1980s and 1990s.

Truth: Stocks have outshined gold over long periods. If you wish to own gold for diversification purposes, go ahead — but don't count on it to drive your future returns. Gold jumped 140% from 2007 through 2012; we don't expect such a robust gain to repeat any time soon.

Myth 3: Past performance projects future returns

If you read fine print or listen to those fast-talk disclosures at the end of investment ads, you know that past performance is no guarantee of future returns. However, a lot of people apparently don't read the fine print — plenty of the investors I meet have purchased stocks because they performed well in the past.

That means they must be winners, right?

Unfortunately, our research suggests the opposite. In back-tests since the end of 1994, stocks with the best three- or five-year returns have gone on to deliver 12-month returns *lower* than those of the average stock in the S&P 1500 Index.

Truth: We consider three- and five-year total returns in computing the Performance score — and those long-term returns are an inverse variable, with the strongest performers earning the weakest ranks.

Myth 4: Never sell stocks with a high yield-to-cost

At first blush, yield-to-cost sounds like a useful concept. Suppose you bought Family Dollar Stores (*FDO*) 20 years ago, when the shares cost \$4 adjusted for splits. Today's dividend represents a 1.6% yield relative to the purchase price.

Too many investors would look at that number and say, "I can't sell Family Dollar because I'd never replace that income." The problem with this thinking is twofold.

1) The real yield isn't as high as you think. Family Dollar may have a yield-to-cost of 31.3%, but based on today's price it yields 1.6%. You can replace the income with any other stock yielding that much or more.

2) It's not 20 years ago anymore. The previous statement sounds too obvious, but investors can anchor on when they purchased a stock, to their own ruin. Remember that you own the stock today, and how much it pays

out relative to its value when you purchased it has no bearing on whether or not it can deliver strong total returns going forward.

Truth: Anchoring on a purchase price, whether you're considering yield-to-cost or just trying to break even after a stock falls, can lead to poor investment decisions. Cost basis affects your tax liability, of course, but in most cases the prospect of paying taxes shouldn't keep you from selling a subpar stock. Excluding taxes, only two prices matter — a stock's current price, and the price you think it can achieve in the future.