

Why You Don't Want to Invest Like an Expert

The way some finance professors manage their money offers valuable lessons—in what *not* to do



▶ **Investing has a few simple rules** that everyone knows are true yet most people find amazingly hard to live by. Diversify; don't chase hot returns; don't think you can outsmart the market. If you did nothing more and nothing less, your success would be all but ensured. Turns out regular folks like you and me aren't the only ones who struggle to live by these precepts. A new survey shows that finance professors—the experts who analyze markets and teach future mutual fund managers how to build portfolios—have the same willpower problems as the rest of us. We can learn something about how to address our own shortcomings if we study theirs.

Colby Wright, a young scholar at Central Michigan University, surveyed more than 600 finance professors at major U.S. universities to find out how they invest their own money. It turns out that most keep things simple and smart: They do little or no stock picking, and they avoid investing in options, future contracts or other more esoteric securities. About two-thirds of the professors, in fact, have the bulk of their assets in index funds, the low-cost baskets that essentially own the entire market. These academics more or less practice the basic lesson of modern portfolio theory: Diversification is the key to holding down your risk and maximizing your returns. That leaves a third who have gone astray, however.

SO MUCH FOR THEORY

In their classrooms, these professors lecture on complex theories of how markets balance risk and return. In their portfolios, though, the traders ignore that mumbo-jumbo. How do they decide when a stock is a buy? By doing a discounted cash flow analysis? Or consulting the capital asset pricing model? Heck no. Like any CNBC

junkie, they zero in on how much the price has risen over the past six to 12 months. To heck with theory—that sucker's going up!

Worse still, among the 44% of professors who believe that the market is efficient—meaning that whatever is knowable is already priced into stocks—nearly a quarter nevertheless agree with the statement “When I invest my own money, my goal is to beat the market.” In other words, hav-

hard it is to beat the market, nobody stops trying. Let me rephrase that: Everybody knows how hard it is for everybody else to beat the market. So you and I are always honest about each other's chances of success but never about our own.

DO AS I SAY, NOT AS I INVEST

44%

Finance professors who think that it's all but impossible to beat the market's return

23%

Percentage of those professors who nevertheless try to beat the market

SOURCE: Colby Wright, Central Michigan University.

ing spent their careers studying the stock market, these experts have concluded that it can't be beaten by anyone—except them. “Professors' perceptions of market efficiency have little, if any, influence on how they invest,” says Wright. “What really drives their investing behavior is their confidence in their own abilities”

In this, the professors are just like the rest of us. Although everybody knows how

THE REAL LESSONS

There are two important bits of learning embedded in Wright's survey data.

First, whenever anyone tells you that research “proves” a novel method of investing is a market beater, bear in mind that the professor behind the paper is most likely an indexer who has never road-tested his theory in the real world of trading costs, taxes and other expenses.

Second, remember that even many of the people who know best can't resist chasing hot stocks, so you have to control your behavior in advance. Put 90% of your money in low-cost index funds and lock yourself in by adding a fixed amount every month through an electronic transfer from your bank.

Speculate with just the remaining 10%, and use a checklist of buying criteria to make sure you never buy a stock purely because it has been going up. You can buy a stock only from someone who doesn't want it anymore. You don't have to be a finance professor—in fact, maybe you shouldn't be one—to realize that the seller may know something you don't. The less you fool with your portfolio, the less often you'll play the fool. **\$**

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