

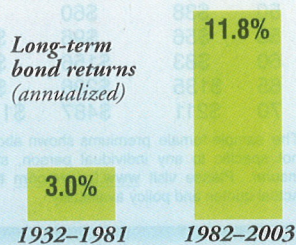
be a calmer investor

paying attention to the present missed out on the future. From 1982 through 2003, long-term bonds returned a fat 11.8% annually, just two percentage points less than stocks with only a fraction of their turbulence. History is worthless if you forget to filter it through the sieve of common sense.

Watch, also, for the two most common pitfalls in market statistics. The first is "time dependency," in which a minor change in measurement period can make a major difference in returns. Sure, Firsthand Technology Value fund outperformed Standard & Poor's 500-stock index by 45.9 percentage points last year. But in 2002, the fund underperformed the index by 34.1 points. So you should never judge past returns by a

Past and future are not the same

In 1982, looking at past returns on bonds would have taught you exactly the wrong lesson about how to invest. You can't draw historical lessons without using common sense.



Source: Ibbotson Associates.

single measurement period; instead, look at as many periods as possible. The second pitfall is "survivor bias," in which the losers are left out of the data. Prof. Jeremy Siegel's famous *Stocks for the Long Run* numbers, for example, are based on returns from as few as seven (yes, seven!) stocks at the dawn of the U.S. market, when hundreds of others

were going bankrupt. Remember that the next time someone tries to tell you that two centuries of market data "prove" that stocks will always beat bonds in the long run.

Finally, get yourself a copy of Darrell Huff's classic, *How to Lie with Statistics*, perhaps the best book not officially about investing that an investor could ever read. Short, funny and unforgettable, it will show you how to talk back to numbers and the people who try to use them to pick your pockets.

5 Less is more

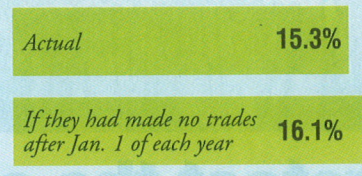
Often, the more you trade, the less you make (see the chart at right). A big reason: costs. Dozens of finance professors and other researchers have studied the performance of mutual funds and stock pickers, and there's only one thing they all agree on: Over time, investors who keep their costs down will outperform those who don't. Warren Buffett has estimated that the investing public pays about \$130 billion a year in brokerage costs, fund management fees and other expenses. Considering that the companies in the S&P 500 generated total operating income of \$137.6 billion last year, Buffett's math has an astounding implication: that we investors are turning most of our rightful share in corporate America's profits over to the intermediaries who handle our money for us.

If you set your expectations realistically, the need to keep your investing costs at rock bottom becomes even clearer. Assume conservatively that stocks are likely to return about 6% annually and that inflation will run at 2% to 3%. That leaves a net return (before taxes!) of 3% to 4%. Between management fees, sales charges and trading costs, the typical mutual fund

When no action is the right action

Here's how fund managers would have fared over eight years if they had been calmer investors.

Average annual return for large equity funds 1983-1990



Note: Study compared actual pension fund returns for 1983 to 1990 with returns that the managers would have earned had they made no trades after Jan. 1 of each year. Source: Finance professors Josef Lakonishok, Andrei Shleifer and Robert Vishny.

costs between 2% and 3% annually. Even if you buy stocks directly, your brokerage expenses will probably run between 1% and 2%. Thus, the people who handle your money will keep between one-third and three-quarters of your return for themselves. If that's not stressful, what is?

Luckily, how much you pay to invest is almost entirely within your control. Buy no mutual fund that charges over 1% in annual fees. (Using an index fund like Vanguard Total Stock Market, you can own every stock worth having for as little as 0.2% of assets—just \$2 a year on every \$1,000 you invest.) Get your own trading costs down close to zero by thinking like an owner, not a renter of stocks. Harvest your losses once a year to minimize your tax bills. As Benjamin Franklin wrote more than 200 years ago, "Human Felicity is produc'd not so much by great Pieces of good Fortune that seldom happen, as by little Advantages that occur every day." By taking control of your costs, you can pile your savings higher with each passing day. Little things mean a lot!

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