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Hazardous to Your Wealth

Overview: The massive downturn in the market in 2008 provided active managers and stock forecasters several opportunities to demonstrate their value. The following shows that even with a low bar set for outperformance, they had a difficult time meeting the challenge.

There's little doubt 2008 was a tough year for investors, as the stock market turned in one of its worst performances in history. The S&P 500 Index, for example, was down 37 percent for the year — the worst performance for the S&P 500 since 1931, when it fell 43 percent.

But such a dramatic downturn in the market should have provided active fund managers with ample opportunities to outperform. Even turning in stock picks that simply finished the year in the same place they started would have significantly outperformed the market.

Given the massive amount of media coverage of the current market conditions, one would think that managers that beat the market would be heavily touted right now. But those stories seem to be few and far between. In fact, by looking back at some of the predictions offered in late 2007 and early 2008, investors can see that active management still has not proven to be the winning strategy.

Swing and a Miss

In a December 31, 2007 article "What the Pros Are Saying," *BusinessWeek* surveyed several prominent investment analysts and managers about their thoughts on the performance of the stock market during 2008. One money manager surveyed had previously achieved fame by advising clients to sell before the stock market crash of October 1987.

Her outlook was much more upbeat this time around. She predicted that the Dow Jones Industrial Average (DJIA) and the S&P 500 would both post 20 percent gains. "Our models show the S&P 500 is undervalued by 25 percent."

Not quite. The DJIA fell by 31.9 percent and the S&P 500 finished 2008 down 37 percent. As an added insult, this manager had been advising clients to buy stocks her firm felt were significantly beaten down, specifically mentioning Lehman Brothers (which failed), Bear Stearns (which was rescued by JP Morgan) and Merrill Lynch (which was absorbed by Bank of America).

Big Bets on Big Banks

The January 7, 2008 *Forbes* article "Seize the Day" acknowledged that financial stocks had been hit hard by the credit crunch. Still, investors looking for cheap stocks with good potential were steered toward banks: "Those who buy bank stocks should be well rewarded over the next couple of years."

To be fair, the article's author was looking further down the road than just in 2008. Still, the group of stocks recommended to investors reads like a who's who of the top financial bad news makers of the year:

Recommended Stocks	
Company Name	**2008 Return**
Bank of America	–63.1%
Wachovia	–84.7%
Citigroup	–76.0%
KeyCorp	–61.6%
JP Morgan	–25.1%
Washington Mutual	–99.8%
Freddie Mac	–97.8%
Benchmark	**2008 Return**
S&P 500	–37.0%

Best of the Old and Best of the New

How about the top fund managers of today? Would they be able to spot value in the market chaos? Could they outperform the market and keep their impressive track records? The December 24, 2007 *Fortune* article "Old Masters and New Classics" profiled the magazine's best bets for funds that would deliver solid returns. "Old or new, one thing's for sure: With the stock market booming or swooning depending on the news of the day, it's more worthwhile than ever to have one of these steady hands guiding your investment decisions," the article read.

The article picked six funds: two large-cap, one mid-cap, one small-cap and two international funds. An evenly weighted portfolio of these six funds would have returned –41.7 percent in 2008. By comparison, a portfolio of two-thirds S&P 500 and one-third MSCI EAFE Index would have yielded a return of –39.1 percent in 2008.

Summary

Even though the poor market performance in 2008 provided opportunities for many prognosticators to demonstrate their abilities, few lived up to the challenge. Instead of following their advice, investors would be better served to listen to financial advisors who account for the investor's ability, willingness and need to take risk and who build financial plans to match.

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