O'Shaughnessy
ASSET MANAGEMENT

Change Your Focus, Change Your Future

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Last week one of my college buddies called. He'd just read my book How to Retire Rich. He's 38 and trying to figure out how to invest the $100,000 he's moving to a rollover IRA from his previous employer's 401(k). "I loved the book, Jim," he said, "but I want to spent zero time worrying about this money. What do you think?" I asked him when he wanted the dough. He said at the earliest, he'd need it 24 years from now when he turned 62.

So let's do the math. And rather than hope for the best, let's assume the worst. Let's say the next 24 years are pretty rotten and the returns my friend earns are similar to the worst 24-year compound returns since 1951. If my friend invests all his savings in T-bills, his IRA would compound at 3.98% a year and his $100,000 would be worth $245,384 when he was 62. T-bills sure aren't a very enriching investment strategy, especially when you look at risk in terms of purchasing power. Indeed, this strategy is incredibly risky in the event of just average inflation rates. In real terms, my friend's investment in T-bills* ravishes his hopes for a secure retirement.

Intermediate-term government bonds aren't much better—if he matched their worst 24-year return, his $100,000 would be worth $265,101 at age 62, a return of 4.33% a year. Yikes! The investments that appear so safe in the short-term look downright foolish in the long-term. Now let's contrast bonds and T-bills with the worst 24-year periods of one my historically tested stock strategies.

Enter Stock Selection Strategies

What if my friend used the Cornerstone Growth Strategy, matching its worst 24-year returns? Here, the numbers tell a far different story. My friend's $100,000 would be worth $2,966,164 at age 62, earning a compound return of 15.88% a year. That's incredible! But to earn that return, my friend must stick with the strategy over the entire 24-year period. That's the rub. To earn this kind of return over the long-term, you must focus on then, not now. You've got to ignore the headlines, the crisis du jour, the hot tips and the short-term desire to always be doing something.

What if now turns out to be like the early 1970s? Between 1973 and 1974, the market lost nearly half its value. My friend starts his investment and watches in horror over the next two years as it falls almost $50,000, cutting his $100,000 virtually in half. How likely is it for him to persevere? Look at the following table. Ask yourself if my friend will be able to stick with the Cornerstone Growth Strategy after those first two years.

Year Ending:	**Cornerstone Growth Strategy**	**$100,000 becomes:**
1973	-27.50%	$72,500
1974	-29.10%	$51,403
1975	37.60%	$70,730
1976	32.50%	$93,717
1977	26.40%	$118,458
1978	38.30%	$163,828
1979	38.70%	$227,229
1980	62.70%	$369,702
1981	- 9.00%	$336,429
1982	37.10%	$461,244

The long-term data would show my friend that even with that awful initial loss, he'd have always beaten cash, bonds and the S&P 500 if he'd stuck with the Cornerstone Growth Strategy for ten years. But without that information, what are the chances that he would stick to this strategy. Slim to none, I'd bet. Even with all the data, if he started investing in the strategy today and lost half his money over the coming two years, the urge for him to say, "well, this strategy used to work, but it doesn't anymore" would likely overwhelm him. Living through a stock market wallop similar to that of 1973 and 1974, he'd probably abandon the stock market all together, running to the "safety" of T-bills or the bank passbook of his childhood.

Don't Follow the Herd

That's exactly what many investors did in the early 1970s, except then they also invested in things like gold and precious coins. Sadly, most investors make the jump after a big decline. The long-term returns those earlier investors in T-bills and gold coins received were just as awful as the ones my friend would probably get if he ran for T-bill cover today.

To make a long-term fortune, you must use long-term methods. Focusing on the short-term almost always begets rotten returns over the long-term. The facts prove it, yet we consistently react to every short-term gyration in the market.

A recent Dalbar Financial survey dramatically demonstrates what happens to nearsighted investors. The study found that between January 1, 1984 and December 31, 1997, the S&P 500 gained 819.92%, yet the average equity fund investor barely stayed ahead of T-bills, gaining just 148.3%! Good God—why? The study concluded that investors' poor performance was due to their attempts to time the market and their inability to stick with an investment or investment strategy.

To make a fortune over the long-term, you must remember the odds. Since the stock market was founded in the late 1700's, stock prices have gone up 71% of the time. Simple math shows that long-term investors bet heavily against the odds if they ever hold anything but stocks. I like to take this idea one step further, telling long-term investors to stay fully invested in the market while using investment strategies that have proven themselves over long periods of time.

To invest wisely, look at the worst return for the time period you have to invest, expect to get it, and choose accordingly. If you have more than ten years to go before you plan to retire or need to use your savings, and you can stick it out, history suggests that even at today's high levels, a strategy like Cornerstone Growth makes sense. All you have to do is ignore the headlines. And then, like my friend, spend zero time worrying about it.

* Unlike mutual fund shares and other securities, Treasury instruments are guaranteed by the full faith and credit of the U.S. Government.

Investors should keep in mind that there is no certainty that any investment or strategy will be profitable or successful in achieving investment objectives. Past performance is not an indication of future results.

This commentary was written by Jim O'Shaughnessy while he was the Chairman and Chief Executive Officer at O'Shaughnessy Capital Management.

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