

From *New York Times* bestselling author

**KEN FISHER**

with Lara Hoffmans

# DEBUNKERY

**Learn It, Do It,  
and Profit From It —**

Seeing Through Wall Street's  
Money-Killing Myths



# DEBUNKERY

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## ACKNOWLEDGMENTS

I've always been fortunate to do something I love professionally—grapple with capital markets—and also engage seriously in my two favorite hobbies: writing and redwoods. And when the professional day is over or on the weekends, when it's too dark to tramp around the woods, I enjoy turning to my typewriter. (Which has been, for a very long time now, the computer.)

This is my seventh book—and a fun one to write. Easy, too! My editor won't like me saying this—thinking “easy” means maybe I didn't put in much effort, so you won't get much benefit. Not true! Hopefully you will get huge benefit. What I mean by “easy” is these are all short lessons that are near and dear to my heart. Many are ones I've even written on before—in different ways and formats and venues—some of which have been previously published and many of which haven't. A lot are ones I've written about before in short pieces for use by my firm. Some I haven't written on but are things I've said repeatedly to clients, in client seminars, in media interviews, etc. Others are newer but still vital core lessons I think about or apply near constantly—or advise others to think about and apply.

There were many topics I considered, but 2010 seemed a particularly good time to attack common investing myths and misperceptions—and how to debunk them. The bad 2008 bear market is still fresh for most investors. And bear markets make people's brains go haywire like nothing but an extreme bull market. Bear markets are emotionally trying and can make folks seek to reduce the near-term pain. That can mean making a radical change to investing strategy; one that may feel better now, but may not be appropriate long term. Ironically, it can end up hurting folks far worse than the pain they feel now—but far down the road when it's too late (or almost too late) to do anything about it. Or, folks seek the safety and comfort of crowds—following

“rules of thumb” or those things that “everyone knows”—and that’s when you can get into real, lasting trouble (as you’ll see in the book). So I decided a book that directly counters common, widely held myths and misperceptions that rob folks of better long-term results was especially relevant now.

And though writing this book was “easy”—it’s never really easy. Which is why I’m fortunate to be graced with a huge supporting cast. Not many authors have vast amounts of smart, talented people chasing down data, confirming facts, and otherwise making sure what I say is what I mean—making my job easier still. (There’s that word again.) Lara Hoffmans was again pulled from her normal duties writing for my firm’s website MarketMinder and overseeing my firm’s imprint with John Wiley & Sons, Fisher Investments Press, to assist me in drafting chapters, checking my edits, and running interference with the research folks to make sure all our statements were supported and factually accurate. So all I had to do was the fun part, writing.

And, as will become quickly apparent, this book is littered with data and analysis. For that, I must thank my firm’s tireless research team, headed by Andrew Teufel—one of the brightest people you can ever meet—and his fearless admirals, Bill Glaser and Mike Hanson. Contributing analysis to the book were Austin Fraser, Akash Patel, Charles Thies, and Jarred Kriz.

And then there are all those graphs—nearly every chapter has one if not more. All that data had to be pulled and checked, then the chart created and formatted. Then checked and re-checked and re-checked again and reformatted again. That takes attention to detail, time, and patience—vast amounts of patience. Leading the charge was the Team Leader of my firm’s Research Analytics and Production team, Matt Schrader, along with analyst Jessica Wolfe. Jessica did the lion’s share of the graph grunt work, has a great eye for detail, and had a terrific attitude throughout—for that I thank her heartily. Also contributing heavily were Brad Rotolo, Jason Belsky, Andrew Bates, Scott Botterman, Lindsey Skopal, Tom Holmes, and Karl Wonstolen.

Not all the graphs were data-driven—we had some hypothetical drawings done by our in-house graphic designer, Leila Amiri. Leila also designed the cover (which I think is pretty cool), and in general is great at putting a creative spin on abstract concepts. Also helping develop cover concepts (for this and my last few books,

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Thanks also, as always, to my agent Jeff Herman. And I must thank the crew at John Wiley & Sons—David Pugh, who shepherded me through my first three books with Wiley (my fourth, fifth, and sixth books)—*The Only Three Questions That Count* (2006), *The Ten Roads to Riches* (2008), and *How to Smell a Rat* (2009). These were all *New York Times* best sellers (as well as hitting other best seller lists—the *Wall Street Journal*, *BusinessWeek*, *USA Today*, and various smaller lists) thanks in no small part to David's fine work, and the fine work of the Wiley team. Laura Walsh has since replaced David, and working with her has been a pleasure. I must also thank Kelly O'Connor and Adriana Johnson, as well as Joan O'Neil, executive publisher at Wiley, who kindly lets me say whatever I want to say.

I must also thank my firm's senior managers—Andrew Teufel (again), Steve Triplett, and Damian Ornani—three of the brightest, most diligent young men (they are younger than me, and therefore will always be “young men”) anyone could have the pleasure of working with. They didn't contribute directly to the book, because they were busy running the moment-to-moment management of my firm, but their contribution is vital to the firm's success—and without my firm's success, I doubt people would want to read what I have to say. Also, many thanks to Jeff Silk, Vice Chairman, whose introspection and insight make the firm—which is my core responsibility—what it is.

Finally, all my gratitude goes to my wife Sherrilyn. Time I spend writing is time spent away from her. The redwoods don't mind when I spend time away from them on weekends. Hopefully she does forever. This book was a blast to work on, and I hope you have a blast reading it.

Ken Fisher  
Woodside, CA

# INTRODUCTION

## Debunkery Made Easy

**W**hat is “debunkery”? It’s a *comberation*. Decades back my wife started calling all the semi-understandable words I made up “comberations”—an operation that is part combination, part abomination and yet you know largely what it means. With debunkery, I hope you intuitively get that it’s myth debunking—with a twist.

The twist is that it’s a game, of sorts. Don’t take that to mean it’s not serious. In this book, we’re dealing with capital markets, investing, and money—serious topics. But games and play are part of how we learn. And debunkery—particularly in investing—is a game requiring dedication and practice. Why not have some fun on the way, if you can? So *debunkery* means unearthing truths or, at the very least, overturning common but widespread and frequently harmful market untruths, myths, and misperceptions most investors fall prey to.

But before going further, let me say that this book is not about some “how-to” system for beating the market. It doesn’t have a market-beating formula or even specifically tell you *how* to invest. If you want a serious primer on overall investing strategy, I refer you to several of my other books. This one is about improving your odds and making fewer mistakes by deploying debunkery.

If you read my 2006 book, *The Only Three Questions That Count*, this can be a companion book—more examples of those three questions at work. Or it can be an introduction for how to (correctly) stand conventional wisdom on its head, where and when appropriate.

## Reduce Your Error Rate . . . If You Can

A huge part of successful investing is just avoiding common errors most folks make repeatedly—that’s the focus of this book. Most folks can’t accept, in their bones, that investing isn’t a certainties game. Can’t be. Capital markets are far too complex. Instead, investing is a probabilities game—like medicine, engineering, and most sciences. We accept this about medicine—we know the risks of medications or procedures. There are no fail-safes, no guarantees. And yet, for some reason, investors demand absolutes from investing. This leads to serious errors.

All investors make mistakes. Even the very best—repeatedly. I make mistakes—lots of them. Some huge ones! I’ll make more in the future—I promise. If you think you won’t, you’re wrong. If you think you haven’t, you either haven’t done much or you’re delusional. My father was an admirer of Herbert H. Dow, the founder of Dow Chemical (America’s largest chemical company) who famously said, “Never promote someone who hasn’t made some serious mistakes because you would be promoting someone who hasn’t done enough.” That applies equally to investing. The very best—and those who have been the very best the longest—still have made lots and lots of mistakes. Pretty much no long-term investor has been right in their decisions more than about 70 percent of the time. If you get up close to those levels over the long term, you become a living legend. Plenty of folks think Warren Buffett is the all-time best investor—and I’m not being critical of him in any way, but even he’s had some famous doozies. Everyone does. The goal isn’t to be error-free; it’s to be right more than wrong over time.

Overwhelmingly, most investors are wrong more than they’re right. When you’re wrong more than right, you lag the market. When you’re right more than wrong, you can become one of the small percentage of investors, amateur or professional, who beat the market. So reducing your error rate is a worthy goal.

If you can accept that you’re going to make mistakes—lots of them—you will be a better-adjusted investor (and your spouse will like you better, too). But if you can accept you will make mistakes, *and* aim to try to lower your error rate, you can be better adjusted, but also probably get better future results. Far better than most! That’s what this book is about—showing you some common misperceptions—ones that can lead to serious errors. Knowing about them

means you can learn to better avoid them. But more importantly, in the process, I hope you see it can be fun to figure out even more of these misperceptions for yourself, enabling you to do more debunkery on your own.

### *Getting It So Wrong*

Many folks find it hard to believe that a huge swath of investors—professionals, pundits, academics, and even seasoned individual investors—frequently see the world completely wrong. And basically have done so and will do so forever—repeating the same silly mistakes over, and over, and over.

But you know it's true—why else do the bulk of professional investors fail to beat the market? It isn't because they have a low IQ. They don't. (Most are smarter than I am, to be sure, which isn't that hard to do). And why else do so many investors, among those who lag markets, do it so extremely? Why do folks pile heavily into so-called “hot” areas just in time for them to go cold and then do it again and again, repeating their error? And why do they sit idly by and miss the huge booms off bear markets bottoms while waiting for a “more clear” future that never comes?

Maybe you think you don't see the world wrong, and you do pretty well—that it's those other people who do badly. Great! (Though, keep in mind, overestimating one's investing skills is a common cognitive error.) But even if you're already a very good investor, you can still benefit from lowering your error rate. Everyone can. I'm 60 years old and I'm still working on it. Let me say that again. I've got a long-term history of being among the few to have beaten the market in the long term,\* run a big firm managing over \$32 billion,<sup>1</sup> have written the “Portfolio Strategy” column at *Forbes* for 26 years now, have written seven books (including this one), three of

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\*The Fisher Investments Private Client Group (FI PCG) Global Total Return (GTR) strategy was inception on January 1, 1995 and is managed against the MSCI World Index. For the period from inception through December 31, 2009, performance returns (net of advisory fees, commissions and other expenses, and reflecting the reinvestment of dividends and other earnings) of the FI PCG GTR composite have exceeded the total returns of the MSCI World Index as well as the S&P 500 Index. Past performance is no guarantee of future returns. Investing in stock markets involves the risk of loss.

which were *New York Times* bestsellers—and I have a lot less of my career ahead of me than I have behind me. But still I’m trying to learn continuously how to lower my error rate because it is one of the only things you can do that really makes impact.

So why do people so commonly see the investing world so wrongly and become so error prone? A big part is our brains didn’t evolve to deal with capital markets. Humans are intuitive creatures, but markets are inherently counterintuitive. “Common sense” thinking as well as gut instinct—fundamental in so many other parts of our lives and, in fact, often crucial—frequently hurts you big with investing. Folks are also blinded by biases, ideology, or any number of cognitive errors (which we will delve into). Behavioral finance, a now-maturing school of thought, looks at the many ways our ancestral brains trip us up in investing.

Another problem: Sometimes, things change. They used to work and stopped working. Or they work at some times, but not others. Why? The stock market is an efficient discounter of widely known information. But folks have a hard time shifting their views, particularly when for so long so many smart people believed something. And the longer something seems to be working, the less likely those who believe in it seem to be able to contemplate that it may stop working. Never take anything on faith.

For example, decades ago, access to information was hard to get and expensive to come by. If investors could get key information somehow—any which way—that often gave them real power. Now, anyone anywhere can get firm earnings, balance sheets, valuations, and more information than most people’s brains can process—nearly instantly.

My first book, *Super Stocks*, was about using the price-to-sales ratio (PSR) to find super stock bargains. It was a concept unknown and hence not understood before then. And it worked! For a while. But over time, the PSR became popular and easy to find (back in the day, I had to pay to get the data, then basically derive the ratio myself). Today, you can get all the PSRs you want free on the Internet. So PSR, on its own, has lost much of the predictive power it once had. It can still help you at times, but you must know when those times are. (I discuss this more in *The Only Three Questions That Count*.) That’s why you can’t always rely on something that once worked to keep working like it did. What markets do and don’t price into current stock prices evolves. Always.

Another reason investors get it wrong: The financial services industry sometimes teaches investors they need things they really don't. Why? Products with big paydays can be very bewitching to sell. Stop-losses (Bunk 12), covered calls (Bunk 13), dollar-cost averaging (Bunk 14), variable and equity-indexed annuities (Bunks 15 and 16) are all sold, usually, as ways to mitigate risk. But as applied, they're bunk, as you will see. And they can increase risk badly. But they certainly do increase commissions to the sales person. There is no doubt about that, and I'll show you that clearly.

## Debunkery 101

There is an age-old saying Warren Buffett has re-popularized in recent decades: "You should be greedy when others are fearful and fearful when others are greedy." Good advice and particularly true at sentiment extremes. But in between those times, there's a vast muddiness of sentiment that often confuses. What if half the people are greedy and half fearful? Which half do you believe? Who? And why? Maybe you run with one pack or the other. But what are the odds you're right? And how might you measure that? That is just when you need the clarity that debunkery can provide.

Once you intuitively accept that 1) lots of commonly accepted investing wisdom isn't wise, and 2) you will still make mistakes anyway but can aim to lower your error rate and improve your results, actually doing debunkery can be easy. Simple really! To do debunkery, you can:

- **Scale.** Big numbers are always scary! That's the Stone Age part of our still-evolving brains. But if you consider big numbers in proper context, they may not only seem not-so-scary, but can become downright cuddly.
- **Be counterintuitive.** Ignore common sense as a guidepost and instead think counterintuitively.
- **Check history.** Endlessly, you hear in the media, "XYZ happened, and that's bad." Or, "ABC would be good!" But is there any evidence that XYZ historically led to bad or ABC to good? It's usually easy to check, yet few think to. If something hasn't reliably led to the expected outcome in the past, then folks need to explain why this time will be extraordinarily different. They usually can't.

- **Think globally.** It’s amazing how distorted investors’ world-views can be, simply because they don’t think outside their home borders. If you think globally, a lot of misconceptions melt away. Substitute thinking “outside the box” with “outside your country.”
- **Check data yourself.** This is like checking history. Now, ample free historic data exists so you can examine almost everything on your own.
- **Run some simple correlations.** Learn to use Excel. If you read that X leads to Y, check it yourself and see. Very frequently, when most people believe X leads to Y, it doesn’t. Maybe it doesn’t lead to anything at all, or it leads to something totally different—like Q!
- **If most people believe something is true—question it.** Flip common knowledge on its head. If everyone says something is bad, dare to ask, “What if it’s good?” Then check historic data and run correlations to see. (And vice versa—see if something everyone thinks is good is really bad.)
- **Do a “four-box” to check outcomes.** I’ll teach you how. Example: It’s common to hear a down January foreshadows an overall down year. Check the four possible outcomes historically—down January and down year, down-up, up-up, up-down—to see if this myth holds water. (We do this in Bunk 24 and elsewhere.)

I’ll show you how to do all these things (and more) in this book. Sometimes you can attack misperceptions with just one of these, sometimes a combination. But learn to do them all. Practice! Take what you learn here and apply it in different ways to different investing beliefs. Or start by disproving what I show in these pages. That would be great practice.

## Standing Convention on Its Head

When I was young and first went to forestry school hoping to be a forester, we learned that my beloved redwoods needed summer fog baths to successfully reproduce via cone (which is true). The presumption was that more fog was better—a linear function. Partly this was from the common sense observation that the tallest and biggest redwoods were toward the north of the California coastal

range, where the fog is heaviest. This became common wisdom. In the last few years, my young friend Steve Sillett (a professor at Humboldt State University—smack dab amidst the best redwood groves) proved that up to a point that's true.

But after that point, too much fog is counterproductive, and more sunlight becomes more important. That's just been shown in the last few years, standing 100 years of conventional wisdom on its head. That's what investing should be like, looking for things you can challenge—that stand conventional wisdom and common sense on their heads, whether that becomes uncomfortable for you (or fun).

A sidenote: You needn't believe everything or anything I say here. Not at all! After all, I've just told you to not take anything on faith. So you don't have to take what I say on faith either. But then, just because you don't accept what I say, don't simply respond, "That's silly! I don't believe it!" That's just using your intuition, gut instincts, and common sense, all the things the stock market—or rather, by its proper name, The Great Humiliator—wants to use against you (and which most investors do so terribly with). No—instead, take the time to prove you're right and I'm wrong, using the same basic statistical and analytic tools. It's a worthwhile exercise. Besides, I'm going to make lots of strong claims later on, so proving me wrong could be both rewarding and fun for you.

Also, remember, because capital markets are incredibly complex, things don't always work the way you think—even if you've successfully debunked a market myth. Again, investing is a probabilities game, not a certainties game. Not often, but sometimes, the low probability thing happens—you can get 100 heads in a row when flipping a coin. It happens. Doesn't mean you should bet on 100 heads in a row. Highly unlikely! But when the unlikely happens, you dust yourself off, learn what you can, and move on.

## Misperceptions on Parade

Like two of my earlier books, *The Wall Street Waltz* (1987) and *100 Minds That Made the Market* (1993), this book is meant to be read in bite-size chunks—where you can read one chapter or many—and not necessarily in any particular order. Feel free to skip around! Dive in anywhere. Some chapters link to others and provide further background—and point to each other—but I'll tell you when that

happens. Ultimately, this book is meant to deliver short lessons in just a few pages that are applicable right away. Or the book can be several hours of continuous reading. Your choice!

And as you read and start practicing, you'll find all the chapters fit pretty nicely into one of five categories:

1. **Basic Bunk to Make You Broke:** These are the biggest, most basic misperceptions about the very fundamentals of capital markets and Capitalism. Start here, and if you read nothing else, read this section.
2. **Wall Street Wisdom:** Sometimes the industry itself is set up in a way that helps you fail. Seeing through these myths helps you determine what's real, what's costly (though overall fairly harmless) tradition, and what's downright deadly.
3. **"Everyone Knows":** Rules of thumb and other "common wisdoms" can feel comforting, but that doesn't mean they're right. These are all bits of bunk everyone knows but shouldn't.
4. **History Lessons:** A lot of harmful bunk persists because folks fail to check if what they believe is true with a simple scan of historic data.
5. **It's a Great Big World!** It's amazing how much bunk endures because people fail to think globally. Do so, and you won't fall for any of these.

In each section you'll use all the standard debunkery tactics—and more I'll introduce in the book. But this book is by no means exhaustive, nor is it intended to be. I could write 10 encyclopedias on market myth and misperceptions and barely scratch the surface. But no publisher wants to publish a 2,000-page book, and you can learn enough in these few pages to get the rest on your own, which is the most valuable thing I could possibly give you.

Included here are those misperceptions I've run into most in recent years—hearing them on TV, seeing them in headlines, hearing them from clients or my *Forbes* readers, in conversation with other professionals, etc.—and therefore the ones I think you'll run into most now and immediately ahead. Some are timeless, others are newer and more pertinent in 2010 (and beyond).

And some flip in and out of favor. You might go years without hearing folks gripe about our too-big trade deficit, then that fear

comes roaring back (Bunk 48). And some fears flip-flop regularly—sometimes folks fear a too-weak dollar, then shift to fear a too-strong dollar, as if some perfect state of dollar balance exists. (It doesn't—or at least not that can be discerned circa 2010. See Bunk 27.) So this book serves as a handbook to potential error-inducing misperceptions, but also as a workbook to learn how to do debunkery on your own afterward and forever.

And whether you believe some, most, or none of these yourself, this book is still useful because these are mistruths that, overall, most investors believe—at least I think they are. There's real power in seeing the world more clearly than most.

With that, it's time for some debunkery. I hope you enjoy the book, and I hope you enjoy playing the very tough but rewarding game of investing. It can be even more rewarding if you see the world more clearly with debunkery.



# PART

# 1

# BASIC BUNK TO MAKE YOU BROKE

There are myriad reasons investors fail, long term, to get the returns they want. Folks have a romantic notion about “beating the market.” A lofty goal—and possible, though difficult—but most investors not only fail to beat the market; they don’t match the market or come anywhere close.

You’d think with all of today’s technology and instant information, we’d have banked on all that past collective wisdom and do better at investing—overall and on average. Yet, overwhelmingly, investors don’t.

There’s no one reason, but a major reason—maybe the primary one—is our brains aren’t set up to do this stuff right. (I’ll talk about this more in future chapters.) Our brains evolved to keep us warm, dry, fed, and safe from charging beasts. That helps us in our quest to build taller, stronger, safer buildings and develop life-saving vaccines, but it does nothing in our quest to conquer capital markets. In fact, it can hurt us. Humans are intuitive creatures; markets are inherently counterintuitive.

Simply, the way our brains evolved can make us see the world completely wrong. We see heightened risk exactly when risk is actually least. (Bunks 7, 9.) We seek patterns where there are none (Bunk 10)—we want to see order in something that is inherently and beautifully chaotic. Then, despite our innate desire to assign meaning when there is none, we completely ignore obvious patterns—even mock them! (Bunks 1, 2.)

Part 1 deals with the most basic fundamental misunderstandings. These aren't mere theoretical disagreements—these are misperceptions that can cause investors to make lasting, costly errors. For example, despite decades—centuries even—of historic evidence, investors overwhelmingly cannot get, in their bones, that stocks rise more than fall. (Bunks 1, 2, 6, 8.)

Investors are also compelled to think too short term. Humans are obsessed with near-term survival—have to be! That helped us survive the colder months and stay fed, but it makes humans think about the investing future all wrong—to their detriment. (Bunks 3, 4, 8.) And though most investors (those with long-term growth goals, i.e., almost everyone reading this book) *know* they should think long term—and even say so in cooler moments—all that can go out the window once volatility kicks up. (Bunks 1, 6, 7, 8.) And once you make one or a few strategy shifts driven not by rational, cool-headed, long-term goals but by greed, fear, anxiety, indigestion, insomnia, what-have-you, you can seriously erode the chances you get anything near equities' long-term average growth. (Bunks 2, 5.)

And volatility! Drives folks crazy—because they can't train themselves to think long term. But volatility is normal. Even the most grizzled old investor can forget: In capital markets, averages are just that—averages. Reality can be wildly extreme—and that's normal. (Bunks 5, 7, 9.) Folks who fail to understand that may not only get unnerved and end up missing the likely superior long-term return of stocks—they can even get robbed blind! (Bunk 11.)

Ultimately, these are misperceptions that fade away if you can get, in your bones, the power of Capitalism—that human ingenuity is boundless, and that ingenuity eventually shows in future firm earnings, which goad stock prices higher over the long term. And that if you exchange the future uncertainty of likely higher returns from stocks for the nearer-term certainty of guaranteed returns—through a risk-free investment like a Treasury—finance theory and history both say you get a lower return. That's the risk/reward trade-off. (Bunks 1, 2, 3, 4, 5, 6, etc., etc., etc., etc.)

And if you don't believe in the power of Capitalism, that's fine—you don't have to—it believes in you. Still, if you think, as many perma-pessimists do, that Capitalism is broken, can't work anymore, or is somehow morally wrong, I'm sorry for you, but also you shouldn't be investing in stocks anyway and you probably wasted your money on this book. Many are prone to look at the