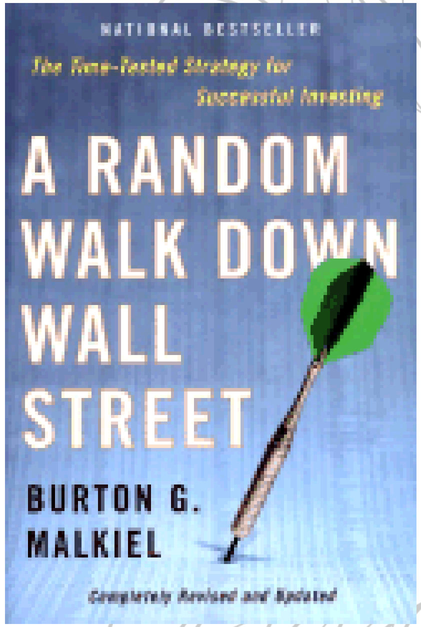
A Random Walk Down Wall Street

Burton Malkiel © 2003 8th Ed., 1st published in 1973

When first released 35 years ago, Burton Malkiel's classic work offered the heretical idea that many investors would be better off buying and holding an index fund than attempting to buy and sell individual securities or hire someone to do that for you. His message is unchanged now after 8 editions and over one million sales.

Besides substantiating this thesis, this book provides an interesting summary of alternative investment approaches, a history of share markets (including during the high inflation '70s) and ideas for managing your portfolio.

According to Malkiel the term "random walk" remains an obscenity to Wall Street veterans.



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For the record …

“No one can consistently predict either the direction of the stock market or the relative attractiveness of individual stocks and thus no one can consistently obtain better overall returns than the market.

And while there are undoubtedly profitable trading opportunities that occasionally appear, these are quickly wiped out once they become known.

Neither technical analysis (charting), which analyses the past price movements of stocks, or fundamental analysis, which analyses basic information about the prospects for individual companies and the economy, seem to yield consistent benefits.

No one person or institution has yet to produce a long term, consistent record of finding money making, risk-adjusted individual stock trading opportunities, particularly if they pay taxes and incur transaction costs”

Investment approaches analysed
- from the serious to the fanciful

Approach	Observations
Technical analysis (or charting)	Method requires past price movements to predict future behaviour and assumes that 90% of stock price is driven by psychology; eg. "trend is your friend", (evidence suggests stock market "has no memory")
Fundamental security analysis	Finds opportunity comparing price to estimated company value, but reported earnings may be dubious, analysts may not be competent or if so, are lost to more important roles; institutional conflicts affect ratings, …
Tactical allocation	About moving money in/out of sectors incl. cash. Can miss market rises; US study found 95% of significant rises came on 90 of roughly 7,500 trading days (30 years); as rises exceed falls, timers must be right 70% of the time
Small companies	Since 1926, US Small caps returned 1.5% over large (risk related)
Low P/E (value)	Evidence excess returns possible over some but not all periods (risk related?)
Dogs of the Dow	Contrarian style of buying past losers (has merit as part of value style)
Listed Invest Co.'s	Buy when asset value is substantially more than listed price (timing risk)
Dividend yield	Theory suggests better future returns if market yield is high (low price)
Monday mornings	Sell stocks on Fridays and buy Monday afternoon, according to pattern
Super bowl	Market success depends on whether AFL or NFL team wins (not reliable)
Odd lot	Trade against small investors who can't afford regular lots (latter not so bad)
Hemline indicator	Bull markets correlate with bare knees in women's fashion (cause or effect?)

Three different eras of financial markets
- a hint of the future?

Era of …	Comfort	Angst	Exuberance
Period	1946 – 1968	1969 – 1981	1982 – 2000
Stock returns* (%pa)	14% (5.0, 6.6, 2.4)	5.6% (3.1, 8.0, -5.5)	18.3% (5.8, 6.8, 5.7)
Bond returns# (%pa)	1.8% (2.7, -0.9)	3.8% (5.9, -2.1)	13.6% (13.0, 0.6)
Inflation Rate (%pa)	2.3%	7.8%	3.3%
History	Consumers celebrated war end spending and growing the economy. Stocks started period at 12 P/E and 5% yield later moving to 18 and 3%. Bonds capped at low rates to fund war later were devalued as interest rates rose	Vietnam war demand followed by oil and food shocks caused inflation to break out finally reined in by tight monetary policy which severely contracted the economy. P/E collapse countered strong earnings growth	Stocks and bonds started period under-valued. P/E grew from 8 to 30. *"A once in a lifetime period to be invested in financial assets".* Gold and oil produced negative returns.

*US Equity returns for period = (Initial dividend yield + growth in earnings + increase in P/E valuation)
US Bond returns for period = (Initial yield + effect of increase in interest rate)

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