A Tale of Twenty Four Hours: why active investing stimulates the sale of antacids ... but not consistent returns

Recently we were treated to a two-day seminar, courtesy of the Dow Jones Industrials Average, on why stock-picking is so often a futile exercise.

On an otherwise pleasant Wednesday in May, the Dow suddenly nose-dived to its worst finish in more than three years. Why? Vague inflation fears ... a slight increase in the consumer-price index ... analysts and traders reading between the lines of the latest (minimal) interest-rate hike by the Federal Reserve.

There was nothing new in all of this, of course. But in the pack psychology of the trading floor, word of a slight up-tick in the CPI ignited a stampede sell-off.

Then less than 24 hours later, stock-pickers abruptly reversed course.

As bargain hunters swooped in, the Dow opened higher on Thursday. By noon, it was drifting within a narrow range. The day ended mixed. Active investors had expended a lot of blood, sweat and tears (not to mention transaction fees) to end up just slightly ahead or just slightly behind.

What are the lessons here?

For one, be advised that hardly a day goes by when one government agency or another does not release a new statistical abstract on unemployment, consumer spending, mortgage rates, trade surpluses or deficits. In and of themselves, these reports are seldom earth-shattering. But reaction and over-reaction by economists and analysts often drive active managers to panicky extremes.

Second: there's a cottage industry of experts who get handsomely paid to read "tea leaves," and their warnings of trouble often are self-fulfilling. It's a deceiving track record.

Another important lesson: the Dow comprises only 30 enormously large stocks. As an indicator of domestic and global trends, any good economist will tell you that slavishly watching the Dow is like gazing through a side window into a multi-level house. You are not getting the full picture (as with, say, the S & P 500).

Every historical study shows that a well diversified, broadly-allocated portfolio encompassing a wide range of asset classes - i.e., custom-indexed portfolios such as VIA IV's - is the only proven path to consistently superior returns over time. We might add, time spans vastly exceeding 24 hours.

For more on this subject, please see our VIA IV Investment Primer.