Debunking Ken Fisher

By Robert Huebscher
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In his latest book, *Debunkery*, Ken Fisher achieves his goal of dispelling many common investment myths and, in doing so, offers his philosophy on how individuals should manage their money. While most of the advice he offers is unequivocally correct, he also makes egregious errors on some serious matters.

This book is intended for retail investors and not advisors, so what I offer here are some points to guide you in your conversations with clients who may have read it.

I'll look first at the meritorious advice Fisher offers and then turn to his more questionable suggestions.

Debunking conventional wisdom

Fisher's book consists of 50 short chapters, each of which debunks a common investment myth. For example, in chapter 25 he counters the adage, "sell in May and go away," with compelling logic and supporting data. I expect virtually all who will read this article have long ago dismissed this myth, but I'm equally certain that many individual investors believe in it. Here is one of the instances where Fisher does a valuable service.

Along similar lines, Fisher convincingly debunks investing strategies tied to which political party is in power, the value of the dollar, budget deficits, tax rates, and other macroeconomic data.

That said, Fisher writes in such an excessively informal style (e.g., "That should kill 'sell in May' forever. Debunkenasia it!") that he often misses the chance to state his overarching point precisely and clearly: Unless an investment strategy is backed by a sound economic rationale, there is no reason to expect that its past results will continue in the future.

In chapter 11, "A Good Con Artist is Hard to Spot," Fisher does an admirable job of warning investors about the key trait shared by Madoff and other frauds: They lack an independent custodian. "Not every adviser who holds assets is a Ponzi schemer, but every Ponzi schemer I've ever seen has had direct access to the cookie jar," Fisher writes. "Don't give it to them."

The most useful advice that Fisher offers, which is relevant for advisors as well as investors, is on his methodology for debunking. Never look simply at averages, Fisher warns. Look at the underlying data and, for example, whether it is skewed by one or two outliers. Verify any purported investment strategy with historical data. “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.”

Most importantly, Fisher urges investors to adopt a contrarian attitude and approach all decisions with more than a healthy dose of skepticism. If investing were as easy as following commonly believed myths, we could all look forward to a comfortable retirement. Fisher is right to begin with the premise that this is not so.

Debunking Fisher

Having given Fisher his due credit, there are some words of caution all his readers need to hear.

According to the book jacket, Ken Fisher manages $32 billion in assets and was ranked #289 on the 2009 Forbes 400 list of richest Americans. As the recipient of many of Fisher Investment’s promotional mailings, I know that much of his success comes from effective marketing.

To the extent that his success comes also from an effective investment strategy, though, one must question whether Fisher revealed that strategy in this book.

Let’s turn to chapter 26, “Low P/Es Mean Low Risk.” In it, Fisher states, “Using P/Es to forecast risk and return over any reasonable time period is about as useful as using an Ouija board.” Fisher is talking about P/E ratios based on 12-month trailing earnings, and in this narrow sense he is correct. When calculated in that manner, P/E ratios provide little useful information.

Fisher does not mention, however, the predictive power of normalized P/E ratios, popularized by Yale professor Robert Shiller, which use earnings averaged over the last 10 years. Those P/E ratios have been shown, by Shiller and others, to be reliably predictive of returns over long (e.g., 10-year) time horizons. That finding has been used, for example, by Michael Kitces to show that sustainable withdrawal rates can be increased by increasing equity allocations when markets are undervalued.

Fisher compounds that oversight when, in chapter 20, he writes, “There is absolutely no way – none – to predict stock market direction 7 or 10 years out unless you can somehow predict future stock supply shifts.”

The notion that stock prices are driven by the supply and demand of securities is one that Fisher advances several times in the book, notably in chapter 10. By contrast, I looked for a discussion of the role that a company's free cash flow generation plays in determining its stock price and could not find one.

Those are errors of omission; errors of direct misrepresentation stand out as well. Fisher addresses the claim that "Passive Investing is Easy" in chapter 17. Here, he begins by mis-defining passive investing, assuming that a passive investor will hold a static asset allocation throughout their lifetime. Even the purest of passive investors will adjust their allocations over time.

The real problem, though, is his claim that passive investing is "very, very hard."

This premise is based on well-known DALBAR studies, which show that equity mutual fund investors consistently underperform the market and that the average holding period of such investors is 3.2 years. From this data, Fisher draws the conclusion that the passive investor is cognitively hard-wired to be intolerable of volatility and therefore attempts to frequently time the market to his or her own demise.

"If passive investing were so easy, people would do it in volume – and you could see it," he says. "But they don't."

In fact, the percentage of assets in ETFs and index mutual funds now stands at approximately 15%, and it is growing. I'm not going to stake a position in the active-passive debate here, but I reject the claim that passive investing is difficult, either because of behavioral biases or for any other reason. Fisher's arguments about investors being too tempted to switch course in rough times apply at least as strongly to active as to passive investors. Passive investing is as easy as active investing; it just hasn't been tried as much.

In chapter 19, "Beta Measures Risk," Fisher takes his most prominent deviation from accepted financial theory. Beta, according to Fisher, is "less than useless," because the historical betas of securities do not predict their future betas.

This is wrong for several reasons. Academic studies have shown that betas do vary over time (it would be remarkable if they didn't), but not nearly to the degree that would render them useless. At the individual security level, the beta of a security will change only if there are macro factors at work – for example, if the company's industry or sector were to become more or less risky relative to the overall market. More likely, volatility at the individual security level is due to unsystematic risk – the kind not measured by beta.

Indeed, the data Fisher presents to support his claim actually refute it. In figures 19.1 and 19.2, he shows that the stocks that fall the most in bear markets bounce back the fastest in bull markets. That's a pretty good *prima facie* case for the stability of beta, yet Fisher inexplicably chooses to interpret this data to reach the opposite conclusion.

Fisher's notion that beta is less than useless is disturbing. Investors are exceedingly well served by recognizing that they are not compensated for taking on unsystematic risk, which can be reduced through diversification, and that the remaining risk, as measured by beta, is unavoidable.

Fisher is often cited as being anti-mutual fund, and he addresses this in chapter 18. Here, he suggests that mutual fund sales loads have value, because they deter investors from switching funds too often. As an antidote to fund switching, Fisher says you should imagine if you sent your spouse on a shopping spree with the equivalent of a sales load whenever you consider shifting funds.

That might be a reasonable way to deter excessive trading, but other comments in this chapter are not helpful. Fisher's anti-fund bias is evident when he says that funds are a "fine vehicle" for smaller investors, but "for big investors there are a million better ways to skin the cat." Presumably, he is referring to the separately managed accounts his firm offers, but he cites no data to support this claim. He admits that higher fees on funds erode returns, but the central point of this chapter is that fees are one of many factors a fund investor should consider. That's dangerous advice to unskilled individual investors, who should begin with the knowledge that low fund fees are the only historically consistent predictor of higher returns.

On balance, *Debunkery* does more harm than good. While I am grateful for those bits of misguided conventional wisdom that Fisher disproves, a naïve reader might acquire advice that is even more harmful. Investors need to be grounded in truisms such as the role of a passive approach, the diversification of unsystematic risk, and keeping fees low. Fisher thinks otherwise, so be warned.