

Summary Descriptions of Articles Included on the paradoxinvestments.com Website

(Denotes article item number on the Website) [Denotes number of pages in the article]

Notes: Some of the article numbers that are provided below are repeated because there are actually four sections to this Website. Articles have been numbered sequentially from 1 to X in each section. Thus, the first section, which is an “Overview,” consists of just 1 article.

The next section, “Quantitative Strategies for Outperforming the Market” contains 18 articles that deal with ways of making money in the stock market.

The next section, “The Capital Asset Pricing Model Revisited,” addresses the theoretical side of the market and contains 8 articles.

Finally, there is a “Miscellaneous” section with a collection of 14 articles that cover a number of topics that are of special interest to the writer.

Overview; Profile of John Maynard Keynes; Keynes Timeless Essay on the Stock Market

(#1) [p9]

- Whatever one’s political leanings, it must be admitted that Keynes was an authentic genius. His seminal *Treatise on Probability*, written at age 38, was deemed by no less an authority than Bertrand Russell to be “one which it is impossible to praise too highly.”
- Here we report on some interesting lore about Keynes and his intellectual development.
- Most importantly, however, is a short essay (included here) that he wrote about the stock market. This essay is considered by many (from Barton Biggs to Nobel laureate James Tobin) to be the most penetrating four pages in print about the machinations of the stock market.

High Growth vs. Cyclical Stocks - Important Differences in the Factors Affecting

Price Performance (#1) [p22]

- Examines reasons for the extended history of superior performance of value related stock selection strategies such as high yield, low price/book, low price/earnings and low price/sales.
- Provides a behavioral and empirically based explanation for the past superior performance of these investment strategies.
- Examines some of the conceptual underpinnings for the distinction between growth and value investing
- Is based on an earlier draft and therefore contains some empirical data that is out of date. Still, we doubt the zebra has changed its stripes in regard to the inferences that can be drawn from this earlier research.

Review of Historic Returns for Common Stocks and Corporate Bonds, 1925-2010 (#1) [p13]

- Examines differences in returns over the past 85 years between the S&P 500 and Long-term Corporate Bonds.
- Introduces the notion that the use of total holding period returns for these securities makes a much clearer statement of return differences than the use of compound annual rates.
- Provides a clear and concise explanation of the “magic” of compound interest or growth.

- Examines some of the critical problems that analysts face when attempting to predict future returns on common stocks or for major market indices.

Cycli-Graphs of Company Earnings and Stock Prices Illustrating Earnings Dominate Influence Over Prices (#10) [p19]

- Examines from a number of perspectives the extremely tight relationship that exists between changes in reported earnings and stock prices across stocks included in the S&P 500 index.
- Contains detailed data on the power of this relationships for the nine years. 2001-2009.
- Reviews both the absolute data and decile rankings to smoke out the closeness of fit between earnings changes and price changes.
- Includes dramatic graphs and tables depicting these relationships.
- Raises serious doubt about the efficient market hypothesis and the theoretical underpinnings of the CAPM given the glue-like relationship between reported EPS and changes in stock prices.
- The Efficient Market Hypothesis is tied inexorably to the concept of “intrinsic value” defined as the (risk adjusted?) discounted present value of all future dividends, presumably over an “infinite horizon.” In point of fact, nothing could be further from the truth!

Price Performance Given Perfect Knowledge of Six-month Earnings Estimates Revisions (#11) [6]

- Consists of several charts and tables illustrating the strong relationship that exists between consensus earnings estimate revisions and stock prices.

Earnings Estimate Revisions and Earnings Surprises in Relation to Stock Prices (#2) [p6]

- Consists of an explanation / clarification of the article, *Earnings Expectations and Security Prices*, that is discussed in the following comment on this article.

Earnings Expectations and Security Prices (#3) [p13]

- Published in the Sept/Oct issue of *The Financial Analysts Journal*.
- Was one of the earliest articles to highlight the consistent relationship that exists between consensus earnings estimate revisions/earnings surprises and stock prices.
- Over a 24 quarter period examined portfolios (comprised of 20 stocks) each that had experienced the largest increases (or revisions) in their consensus earning estimates. The average 12 month return for these portfolios was 29.1% compared to 18.7% for the selection universe and 12.0% for the S&P 500.
- Also introduced a new method of evaluating portfolio performance that consisted of ranking each portfolio's return within a sample of 1,000 random portfolios drawn from the selection universe. The test portfolios achieved an average rank of 783 (out of 1,000) which statistically speaking had a one in five million chance of being due to luck,

Consensus Estimate Revisions and Stock Prices in Declining Markets (#4) [p13]

- Conditionally accepted for publication in The Financial Analyst Journal.
- Updates performance results found in *Earnings Expectations and Security Prices* (for portfolios with the highest revisions in their consensus earnings forecasts) for 12 additional quarters. Performance was similar to that in the previous study
- Answers the question: How should we expect this stock selection model to perform in bear markets?

Investment Characteristics of Stocks Ranked #1 (best) and #5 (worst) on the Value Line Timeliness Rating (#7) [p9]

- The Value Line Timeliness Rating is renowned for its ability to outperform the market over extended periods of time on a risk adjusted basis, as was made clear in Fischer Black's seminal article, "Yes, Virginia There is Still Hope."
- The current article focuses on the fundamental investment criteria that determine the Timeliness Rating for the best ranked (#1) stocks and the lowest ranked (#5) stocks.
- The results are just what a good quantitative financial analyst would expect.

Illustration of the Importance of Value-weighted Stock Selection Criteria to Portfolio Performance (#8) [p5]

- Shows how diversification and weighting across fundamental investment criteria can enhance the expected performance of a given portfolio.

Evidence on the Mispricing of Common Stocks -- The DJIA Reexamined (#9) [p11]

- Examines performance of stocks in the DJIA to illustrate the clear implausibility that price changes for these stocks are driven by a quest to keep them in line with their intrinsic values -- defined as the (risk adjusted?) discounted present value of all future dividends over an "infinite horizon."

Implications of the Yield to Maturity Calculation (#12) [p6]

- As J.C. Van Horne (in *Financial Management and Policy*) once noted: "The yield to maturity or internal rate of return for a bond implies that all cash flows are reinvested at the yield to maturity rate."
- Although the conventional definition of yield to maturity found in most financial texts conforms to the above statement, this article shows that financial equivalency (measured by the time value of money) will always be obtained when two bonds with different coupon rates, market prices and discounts have the same yield to maturity *even though no reinvestment of coupons* takes place.

A Critique of Reaganomics by Paul Samuelson Transformed into an Indictment of DDM/IRR (#4) [p2]

- Makes an analogy between Samuelson's disdain for the notion of a rational and efficient free market economy with the notion that common stocks are always efficiently and correctly priced at their "intrinsic values" -- defined as the (risk adjusted?) discounted present value of all future dividends over an "infinite horizon."

Evidence that Articles in "The Journal of Finance" (i.e., Financial Rocket Science) are a Losing Proposition with Corporate America (#3) [p4]

- Asks the question: Where did all the corporate subscribers to the *Journal of Finance* flee from the end of 1979 (140 subscribers) to the end of 1983 (14 subscribers)? Did they simply conclude that the financial rocket scientists in academia had gotten out of control?

Two Points of View about Risk and Return in the Long Run -- Modigliani vs. Keynes (#2) [p1]

- Simply quotes the written word of these two titans of finance to see who mostly captures reality insofar as the long-term differences in risk between stocks and bonds is concerned.

Equiview: A Rank Order Stock Selection Model (#15) [p4]

- Describes a conventional rank-order selection model designed by this writer using Lotus 123 macros.
- Works in combination with the Value Line 1,500 stock database.

Twenty Three Quarter Backtest for Twelve Indicators of Investment Attractiveness (#5) [p4]

- Equally weighted portfolios comprised of 15, 30 and 60 stocks were selected at quarterly intervals and held for 3 months. The first portfolio was selected on 3-31-81 and the last on 9-30-86. Selection criteria whose availability depended upon corporate quarterly reports *were* only used three months beyond the related fiscal period end-date.
- Average quarterly, as well as cumulative-linked holding period, returns are compared to the equally weighted selection universe and to the cap-weighted S&P 500 composite.
- In all, 36 methods of selecting portfolios were examined that produced an average return over the full six year period of 267%. This compares to a return of 132% for the S&P 500 and 165% for the selection universe. Just as quarterly rebalancing tends to produce better results than annual rebalancing, the smaller portfolios in this study tended to outperform the larger ones.

Seventy Five Quarter Backtest for Three Indicators of Investment Attractiveness (#6) [p4]

- This study examines long-term performance for three value related investment criteria: Price/Earnings, Price/Book and Price/Sales. The universe for the study consisted of all 620 stocks with continuous coverage in Compustat for the 20 years ending December 31, 1986.
- Equally weighted portfolios comprised of 100 stocks were selected at quarterly intervals and rebalanced every three months. The first portfolio was selected on 3-31-68 and the last on 9-30-86, for 75 quarters in all. Because knowledge of latest 12 month's EPS, Book Value and Sales depend upon the availability of corporate quarterly reports, a one-quarter lag for this data was employed.
- The principal findings of this research are shown in a number of tables graphs. They show that results for all three of the criteria were exceptional, with the low P/E model doing 6.3 times as well as the healthy 494% gain for the S&P 500.

The Problem with Quantitative Stock Selection Models (#16) [p1]

- Lists 6 reasons that quantitative stock selection strategies keyed to fundamental investment criteria (such as low P/E, low Price/Book Value, low Price/Sales, Large Earnings Estimate Revisions, Large Earnings Surprises and Small Company Size) are viewed by traditional money managers as pure anathema.

Selected Exhibits (#16) [p16]

- Consists of about 25 one page snapshots of interesting market phenomena.

The Defined Future Earnings Model and the Riddle of Perpetual Claims (#14) [p19]

- Uses a comprehensive model designed by the writer for Excel that examines the Discounted Present Value and/or the Internal Rate of Return of a stock from 12 different perspectives.
- After extensive practice with the model I concluded that the notion common stocks have, can, or will be correctly priced at their true “intrinsic values” defined as the (risk adjusted?) discounted present value of all future dividends over an “infinite horizon.” is a hoax.

Wages on Wall Street vs. Wages for Professors of Finance -- A Case Study in Market Efficiency (#5) [p2]

- Looks at the huge salaries on Wall Street and asks: If the financial sector is so adroit at efficiently / correctly pricing common stocks, how could it have made such a mess out of pricing its own services?

Book Review: The Myth of the Rational Market (#17) [p6]

- Justin Fox has written an elegant and insightful book, “The Myth of the Rational Market,” that thoroughly documents a half century of confusion and misinformation (under the guise of the “efficient market hypothesis” which is a primary target of this Website) about the behavioral underpinnings of the U.S. stock market
- No less an authority than the late Peter Bernstein observed: "This wise and witty book is must reading for anyone who wonders what makes financial markets tick." *Barrons* referred to it as "A lucid, lively and learned account," while *The Economist* praised it as "An intellectual tour-de-force..."
- This section contains two reviews of the book. One by Roger Lowenstein from The Washington Post and the other by Noble laureate Paul Krugman from The New York Times.

Market Efficiency in Doubt (#9) [p6]

- This article demonstrates that the stock market is not at all “efficient” in the way that it was originally claimed to be.

The 1990 Nobel Prize in Economic Science Revisited (#6) [p16]

- Is investing an art or a science as market sages have long debated?
- This article looks at the question from the point of view of two theorists (Noble laureates Markowitz and Sharpe) and two distinguished practitioners (Keynes and Graham)
- Simply points out that these two sets of observers could not be more divided in their perceptions of the reality of the market place.

Is Beta Dead or Alive? (#7) [p12]

- Examines the mathematical language on which the Capital Asset Pricing Model/Beta is based and raises fundamental questions about how millions of investors could have been expected to take its assumptions seriously (whether in the past, present or future) given their lack of understanding of the dynamic math on which the model depends.
- Also questions what past tests of Beta were actually testing

Quantum Mechanics and Capital Market Theory (#8) [p12]

- Conditionally accepted for publication in *The Journal of Portfolio Management*.

- Explores metaphorically the close relationship that exists between physics and modern capital market theory – i.e., Portfolio Selection and the Capital Asset Pricing Model.
- Challenges “economic positivism” on which the CAPM is fundamentally, or spiritually, grounded.

Investment Analytics and the Computerized Investor (#18) [4]

- This article, published in the July 1985 issue of *Wall Street Computer Review*, provides a snapshot of the writer’s early experiences with quantitative investing.

WHAT FOLLOWS ARE SUMMARY DESCRIPTIONS OF ARTICLES IN THE WEBSITE’S MISCELLANEOUS SECTION

Reflections on the Current and Future Status of Social Security (#14) [p15]

- Answers the question of whether Social Security is a bad deal and, if so, for whom?
- Answers the question: What sort of gain in benefits will be available in 2037 (after the trust fund expires) and in 2085 (end of the forecast horizon) for today's youth, in constant \$2011?
- Answers the question: Does Social Security or Medicare most resemble welfare?
- Puts the enigma surrounding the Social Security Trust Fund to rest.
- Puts the massive difference between historic returns on common stocks and government bonds in a very bright light.
- Puts the case for the privatization of Social Security in a negative light.
- Puts the case for partial direct-investment of the trust fund in equities in a positive light.
- Includes previously unpublished observations by Paul Samuelson on the subject of Social Security and Ponzi schemes as well as Samuelson’s belief that the Social Security Trust Fund should have a stake in the equities market.
- Explains the so-called “magic” of compound interest/growth in a succinct and convincing way.
- Puts the huge present value of unfunded liabilities for Social Security in perspective.
- Puts the half-true analogy between Social Security and Ponzi Schemes to rest.

Comment on the Relationship Between Intelligence, Judgment and Success (#10) [p17]

- Examines the age old debate about nature versus nurture insofar as the above measures of human accomplishment are concerned.
- Challenges the conventional wisdom that IQ/SAT scores are the be-all end-all of what intelligence is about.
- Puts the focus on *good judgment*, as distinct from “common sense,” or a “good education” as the prince of all human mental abilities.
- Contains William Benet’s essay, “Genius an Overview,” which is possibly the most incisive four pages written on this intriguing subject.

Cosmic Mischief (#9) [p7]

- Explores the meaning of life from a would-be philosopher’s point of view.
- Includes an eccentric poem on the subject.
- In much need of correction and revision by experts.

Health Care Reform in Perspective (#1) [p14]

- Sheds a little light on the issues in this ongoing ethical and political controversy

China, Compound Interest and Social Security (#2) [p24]

- An earlier attempt at unraveling the Social Security morass.
- Contains some interesting facts about China as well as as well as a section on John Keynes fascination with compound interest or growth.

Perspective on Judicial Independence (#3) [p8]

- Attempts to shed a little light on this burning issue in the law.

Comment on the Investment Attractiveness of Roth IRA's (#4) [p14]

- Makes the case for opening a ROTH IRA account.

The Social Security Trust Fund Revisited (#5) [p14]

- Represents an unsuccessful attempt to publish an 1,100 word comment on this convoluted subject.

Comment on the Juan Williams Affair (#6) [p5]

- Examines the question: Why was Juan Williams fired from NPR?

Bill Bennet's Lapse Explained (#7) [p2]

- Bill Bennet made an outlandish statement about abortion and the nation's crime rate a couple of years ago that created a tempest in the national press. This article attempts to sort out the controversy.

Comment on Harriet Miers Nomination to The Supreme Court (#8) [p5]

- This article addresses the Miers nomination as well Chief Justice John Roberts preposterous claim that he is "merely an umpire calling balls and strikes," as he blithely writes 5/4 decisions that have the same effect as if they were properly authorized amendments to the United States Constitution.

1966 Proposal for a Mutual Fund Investment Company Comprised of the Dow Jones Industrial Average (#11) [p23]

- A missed opportunity if ever there were one. Thus, a Dow Jones indexed mutual fund was offered to the public in March 1998 by Waterhouse Securities.

Opportunities in Convertible Securities Due to Secular Under-valuation of the Stock Market (#12) [18]

- This proposal made in 1979 is a little out of date. However, it does show the degree to which the stock market was chronically undervalued at the time setting the stage for a 2,581.3% rise during the ensuing 20 years, 1979-1999.

Socialism in Perspective (#14) [p4]

- Discusses how far down the road America has already traveled on the road to socialism while leaving open the question of how much further it is likely to go.