Stew'ard·ship' | The moral responsibility for the careful use of money, time and talents.

THE
Fraser *Financial* Report

Adapted from: "He Called the Crash"

Weston Wellington, Down to the Wire February 28, 2013
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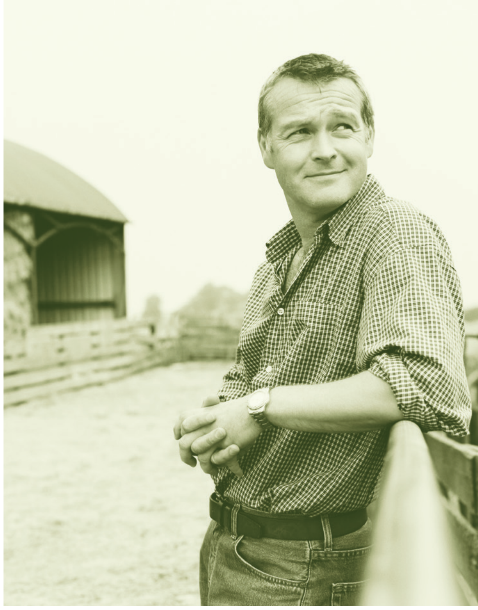

Should investors seek to enhance their returns by applying the statistical timing tools of the late Martin Zweig, who called the crash of 1987? The evidence is mixed at best.

The investment community lost one of its more colorful characters last week with the passing of Martin F. Zweig, a prominent market pundit, author, and chairman of Zweig-DiMenna Associates LLC, a New York investment firm. His death also marks the close of another chapter in the long-running debate on the virtues of market timing.

Zweig took a keen interest in stocks as a teenager, and after earning a PhD in finance from Michigan State University, he began writing investment newsletters while teaching in New York. He launched The Zweig Forecast in 1971 with a handful of subscribers and continued to publish it, with considerable success, for the next 26 years. He transitioned to money management, and in October 1986, he launched the Zweig Fund, a closed-end mutual fund that relied on his analysis of market trends to adjust its exposure to stocks and bonds.

Zweig was a frequent contributor to both print and broadcast media and wrote numerous articles for Barron's, a weekly publication with a devoted following among those seeking comprehensive market statistics. Perhaps his finest hour was an appearance on the television show Wall Street Week with Louis Rukeyser on Friday evening, October 16, 1987. When his host asked him to comment on assertions from other market commentators that the "bull market is dead," Zweig replied he was expecting a crash but was reluctant to say so publicly. It was too similar, he said, to shouting "fire" in a crowded theater. Zweig's prediction proved eerily accurate: The Dow Jones Industrial Average fell by a staggering 29.2% in chaotic trading the following Monday, an even bigger setback than the combined losses from Black Monday and Black Tuesday in October 1929. The Zweig Fund emerged relatively unscathed: According to a profile several years later in SmartMoney, the fund had 58% of its assets in cash leading up to the crash, and experienced a loss of only 6.2% on October 19. Traumatized by the unprecedented market break, many investors sought out advisors or analysts who appeared to have avoided the debacle. Zweig's reputation as a financial expert soared. For years, he was introduced as "the man who called the crash." The headline of Zweig's obituary in the Wall Street Journal described him as a "master market timer."

Should investors seek to enhance their returns by applying Zweig's statistical timing tools? The evidence is mixed at best. Zweig's October 1987 market call was on the money, and the Hulbert Financial Digest once reported that The Zweig Forecast ranked first among market newsletters for risk-adjusted performance. Many investors have discovered, however, that making one or two great predictions is often insufficient to generate above-average long run results—you have to be right over and over again to outperform Mr. Market.

Moreover, it appears that achieving excess returns with real dollars is more challenging than making prescient forecasts in a newspaper column. Annualized return for the Zweig Fund from inception in October 1986 through January 31, 2013, was 6.79% calculated from net asset value. Over this same time period, the annualized return was 9.84% for the S&P 500 Index and 7.90% for a static mix allocated 30% to the S&P 500 Index and 70% to the Barclays Aggregate Bond Index. A tilt toward small cap or value stocks within these indices over this period would have produced even higher returns.

Market timers often acknowledge that their signals do not provide sufficient guidance to outperform a buy-and-hold, 100% equity strategy. Their goal, they say, is to avoid major bear market losses by holding a large fixed-income allocation during market downturns and capturing a meaningful portion of equity market rewards by increasing stock holdings during the upswing. Reducing bear market losses may be a laudable goal, but as this example shows, it can also be pursued with greater simplicity by adopting a lower equity exposure at all times and ignoring the costs and frustrations associated with constant fiddling.

It's safe to say that no one worked more diligently or enthusiastically than Martin Zweig to tease out tomorrow's stock prices from today's data. But the evidence suggests that even the most dedicated student of market statistics is unlikely to meet with long-run success.

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