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How Not To Retire Rich

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The most recent copy of *Fortune* has an eye-catching cover—a prosperous-looking couple gazing serenely across sunlit ocean waters from what appeared to be the deck of an expensive yacht (presumably their yacht). Although the ambiance of comfortable wealth suggested by the photo seemed clear enough, *Fortune* editors took no chances—the typeface for the "Retire Rich" cover headline was so large that abundant future wealth appeared to be not just a possibility but a foregone conclusion.

Inside this annual Retirement Guide issue, readers could find advice on housing bargains; second career possibilities; and where to obtain the best "executive" physical exam. Of course, no self-respecting retirement guide is complete without investment recommendations, and *Fortune* suggested forty stocks—eight from each of five separate categories: "growth and income," "bargain growth," "deep value," "small wonders," and "foreign value." According to the article, the *Fortune* 40 portfolios were introduced in 2002 and have outperformed the S&P 500® Index by a significant margin (annualized return of 15% vs. 11%), although the precise time period was not specified.

Fortune has published an annual Retirement Guide issue for many years, and it seems plausible that the introduction of the *Fortune* 40 strategy in 2002 was at least partly motivated by the erratic performance of stock recommendations in prior years. The retirement issue appearing in mid 1999, for example, followed a more concentrated approach and suggested only ten stocks. Relying on both outside experts and in-house quantitative analysis, *Fortune* at that time assembled a collection of firms "with the size, stability, and earnings power to carry investors through whatever the market throws their way in the decades to come."

Although *Fortune* undoubtedly worked hard to select companies with "the right business plan and the right management," time has not been kind to most of their recommendations. Nine of the ten stocks have underperformed the S&P 500® Index, including two whose shares have been declared worthless in bankruptcy court. Between *Fortune's* quoting date of July 13, 1999 and Friday, June 13, 2008, the *Fortune* 10 stocks fell 46.1%, on average, while the S&P 500® Index (price-only) declined 2.4%.

The table below presents the basis for *Fortune*'s recommendations in 1999 along with a summary of more recent events:

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Stock Price Change
July 13, 1999-June 13, 2008
Adjusted for Splits and Spinoffs

American International Group	**AIG**	**−46.1%**

THEN: "A diverse product mix and big international presence should enable this insurance giant to grow earnings consistently into the next decade. . . . AIG has maintained a 15% annual growth rate over the past *two decades* and shows no sign of slowing down."

NOW: Maurice "Hank" Greenberg, AIG's iron-willed chief executive, transformed an obscure property-casualty insurer into a global colossus over a 37-year period. But when threatened with a corporate indictment from New York state attorney general Eliot Spitzer on charges of improper accounting, AIG directors pressured Greenberg to step down. His successor was overwhelmed with efforts to repair the damage and deal with mounting credit-related problems. He, too, stepped down in early June 2008, a month after the firm announced a record $7.8 billion first-quarter loss.

Bristol-Myers Squibb	**BMY**	**−64.0%**

THEN: "Over the next few years, drugs and other health care stocks should benefit, as millions of baby-boomers head into their 50s and 60s, requiring new treatments for everything from high cholesterol to hypertension to diabetes. . . . With existing drugs selling briskly and a slew of potential blockbusters in the pipeline, Bristol is a smart prescription for long-term investors."

NOW: Company researchers have struggled to come up with major new drugs; and Plavix, the firm's biggest-selling product, is under attack by low-cost generics. In addition, after years of controversy over allegations of improper accounting and weak corporate governance, the chief executive stepped down in September 2006. The spinoff of successful orthopedic device maker Zimmer Holdings (ZMH) has been one of the few bright spots in a discouraging period for shareholders.

Cisco Systems	**CSCO**	**−19.2%**

THEN: "The king of networking should continue to thrive, thanks to the explosive growth of the internet and rising demand for its communications products. . . . Revenue growth is actually accelerating, and profits the next year could easily come in well above expectations."

NOW: Cisco has continued to grow at an impressive rate—earnings per share increased 19% per year for the eight-year period ending 2007—but perhaps not as explosively as investors expected.

Ford Motor	**F**	**−87.4%**

THEN: "A flurry of acquisitions has given Ford a nice stable of high-margin luxury brands, including Lincoln, Volvo, Jaguar, and Aston-Martin. . . . Its profit margin is improving, its production processes are more nimble, and cash flow is strong. Besides, at a P/E of 9.5, it's a good value."

NOW: In recent years, Ford has dismissed thousand of workers, closed plants, sold the Aston-Martin and money-losing Jaguar divisions, and eliminated the shareholder dividend. This year, sales of bread-and-butter products such as the F-150 pickup (the best-selling vehicle in the US for many years) have slumped sharply as buyers worry about rising fuel costs. Weakened by $15 billion in accumulated losses over the previous two years, Ford is in a race against time as it struggles, with limited resources, to refocus its product line to emphasize more fuel-efficient models.

Home Depot	**HD**	**−36.6%**

THEN: "Home Depot has changed the way Americans fix their houses. . . . It already dominates the home improvement market, and it expects to double the number of stores it operates by 2002."

NOW: Competitors such as Lowe's Companies have out-hustled Home Depot in many regions, and sales growth has stalled. A top executive recruited from General Electric to turn things around has come and gone, and the recent slump in housing sales and remodeling activity has further tarnished the outlook.

International Business Machines	**IBM**	**−8.5%**

THEN: "Once assigned to the investment graveyard, Big Blue has staged a remarkable comeback—yet remains one of the most affordable tech plays available. . . .In the internet wars, IBM is an arms supplier."

NOW: Steady growth in consulting and services has kept IBM moving ahead, and the shares have done well relative to other large cap technology firms.

Johnson & Johnson	**JNJ**	**37.0%**

THEN: "Looking for a play on the graying of the baby boom? It's hard to imagine a better bet than J&J, which sells everything from Motrin and Mylanta to prescription drugs."

NOW: Johnson & Johnson has been one of the best-performing major health care stocks over the past nine years, a time of falling share prices for industry giants such as Amgen, Bristol-Myers, Eli Lilly, Merck, Pfizer, Schering Plough, and Wyeth.

MCI WorldCom	**WCOM**	**−100.0%**

THEN: "When it comes to the fast-growing telecom sector of the technology revolution, it's hard to find a better bet than MCI WorldCom. . . . Powered by surging revenue growth from its internet unit, as well as strong international operations, MCI WorldCom is one of the fastest-growing big caps around."

NOW: With 20 million customers and 80,000 employees, the WorldCom bankruptcy filing in July 2002 was the largest in US history. Former CEO Bernard Ebbers was convicted in March 2005 of participating in a massive accounting fraud. Renamed MCI Inc., the firm emerged from bankruptcy in April 2004 and was later acquired by Verizon Communications.

Tyco International	TYC	−34.0%

THEN: "Strategic acquisitions have helped propel earnings up an average of 30% a year. But CEO Dennis Koslowski is picky: he turns down nine out of ten deals."

NOW: At its peak in late 2001, Tyco was among the twenty largest firms in the US as ranked by market value. The shares fell precipitously in early 2002 amid allegations of questionable accounting practices, prompting Kozlowski's resignation in June. He and former chief financial officer Mark Swartz were later convicted of grand larceny and securities fraud and were sentenced to lengthy prison terms.

UAL Corp.	UAL	−100.0%

THEN: "Can an airline be a growth stock? This one can, thanks to a strong domestic hub network and signs of recovery in Asia. . . . All the airlines are inexpensive right now and this one is particularly cheap."

NOW: UAL filed for bankruptcy in early December 2002 after accumulated losses of $3.8 billion in less than two years. United planes continued to fly while the firm reorganized, and the airline emerged from bankruptcy in February 2006. UAL stockholders lost their entire investment.

Our motivation in writing this column is not to skewer the stock-picking skills of *Fortune* editors. Many of these stocks were also recommended by some of the world's most prominent analysts and money managers. *Fortune* editors in 1999 were well aware that many investors were fixated on internet stocks and emphasized the importance of holding a diversified list of proven companies. Considering the widespread conviction at the time that growth stocks in general and technology stocks in particular were destined to outperform for the indefinite future, *Fortune's* choices, drawn from a wide array of industries, looked quite sensible. But time and time again, market participants are blindsided by unexpected events. Even today, it's difficult to find fault with the reasoning behind the various recommendations.

Judging by their most recent advice, *Fortune* editors appear to have recognized that even a carefully researched portfolio of ten stocks is still very risky. (We have not run the numbers, but a list of "Ten Stocks to Last the Decade" appearing in the 2000 Retirement Guide issue included stinkers such as Enron, Broadcom, and Nortel Networks, and therefore appears to have fared even worse.) They should be applauded for recommending a more diversified approach such as the *Fortune* 40. But why stop with this limited number when there are thousands to buy? As Dartmouth professor Ken French has observed, "Diversification is the closest thing to a free lunch. You might as well eat a lot of it."[1]

Especially if you aim to retire rich!

For additional information on how best to put together a truly diversified investment portfolio please contact Ken Weingarten at (609) 620-1770.

1. Kenneth R. French is director, consultant and head of investment policy at Dimensional Fund Advisors.

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