

# JUST HOW IMPORTANT ARE NEWSLETTERS' TELEPHONE HOTLINES?

By Mark Hulbert

Investors seem to prefer newsletters that have hotlines. But do newsletters with hotlines perform any better than those without? A look at the numbers.

One of the questions I'm frequently asked when I talk to AAII local chapters concerns telephone hotlines. These are the tape-recorded messages that newsletters update to allow subscribers, upon calling, to discover their adviser's latest thinking about the market and portfolio recommendations. AAII members want to know: Should they favor newsletters that offer telephone hotlines? Do those letters on average outperform newsletters that don't have hotlines?

The gut reaction of many investors is that the answers to those questions are "yes." The newsletter industry has responded over the years with a proliferation of telephone hotlines.

When I started monitoring the newsletter industry in 1980, just a handful of letters had telephone hotlines. And even those few that did offer them rarely updated them more than once a week. Today, in contrast, no fewer than 99 of the 162 services monitored by the Hulbert Financial Digest have telephone hotlines. Furthermore, many of those letters update their hotline messages as often as daily.

Clearly, the marketplace has spoken: Hotlines are preferable to no hotlines. But what is the truth of the matter? Are newsletters with hotlines genuinely better? That's what I proposed to answer in preparing this article.

## THE STUDY

Let me start by reviewing how the Hulbert Financial Digest accounts for hotline recommendations. The HFD executes a hotline purchase or sale at the average price that prevails in the first full trading session after the hotline is updated. If a newsletter updates its hotline after tonight's close to buy IBM, for example, the HFD would purchase it for the newsletter's model portfolio at the average of tomorrow's high and low prices. This contrasts with how a non-hotline recommendation is measured: In this latter case, the HFD executes the trade at the closing price on the day the newsletter making the recommendation is received in the mail.

Unfortunately, comparing the performances of hotline services with those without hotlines turned out to be quite complex. This is because many of the 99 newsletters that currently have hotlines didn't have them several years ago when the HFD first began to track them. It therefore became necessary to dissect each newsletter's record to discover its performance prior to the hotline, and its performance since.

A good example is Investor's World, edited by John Dessauer, which currently offers a telephone hotline update. Among all letters the HFD has been tracking over the last 15 years, it is in first place on a risk-adjusted basis. On first blush, this would seem to be a victory for the hotline camp.

But on second blush, the view changes. Dessauer inaugurated his hotline in late 1989, and from the date the HFD began following his letter through this

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inauguration date, Dessauer's service produced a 16.6% annualized return. However, from the date the hotline started until now, in contrast, his letter has produced a 13.3% annualized return.

In no way do I mean to suggest that the inauguration of this hotline played any role in causing the diminution in this newsletter's performance. Many other factors also were at work. My point in using the example of Investor's World is to illustrate the difficulties in easily answering the questions that AAIL members ask me.

My response was to construct two composite portfolios for each calendar year; the first included all newsletters that did offer hotlines that year, and the second comprised all those services that did not. The performances of these two composite portfolios are summarized in

Figure 1.

There is remarkably little overall difference in the performances of these composites. On the one hand, the no-hotline composite outperformed the hotline composite in slightly more than half the years (nine of 17). On the other hand, the hotline composite enjoys a slight cumulative advantage over the entire 17-year period, with a 9.54% annualized return compared to 9.25% for the no-hotline composite.

My overall conclusion: There is no statistically significant difference between the performances of newsletters with hotlines and those without.

### IMPLICATIONS

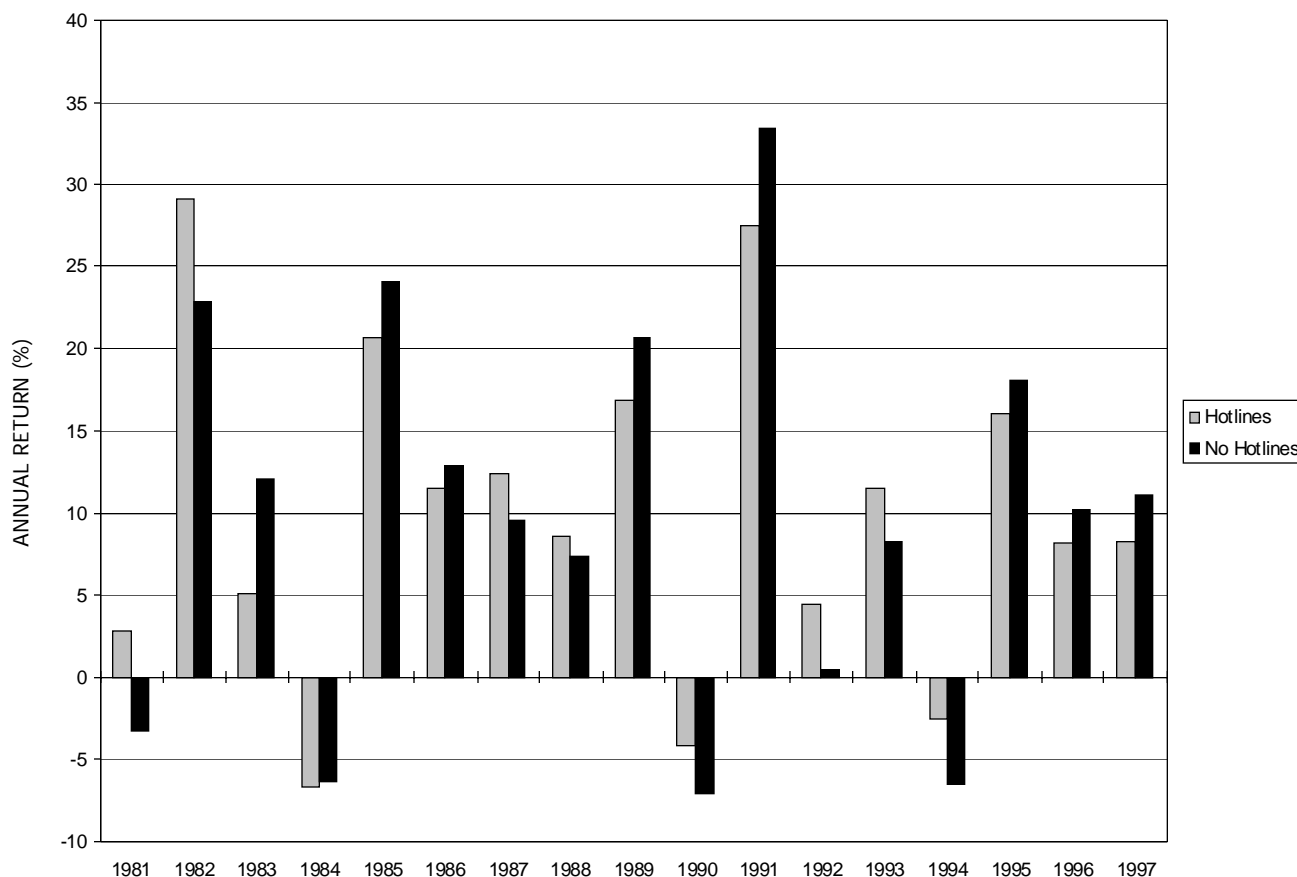
I am not too surprised that hotlines on average don't lead to significantly better performance. To be sure, the

existence of a hotline may be a huge benefit to subscribers—after all, hotlines allow advisers to react immediately to short-term profit opportunities that are beyond the scope of non-hotline advisers.

But there are other factors that tip the scale the other way. Typically, advisers with frequent hotline updates are shorter-term traders, with many more portfolio transactions. If they are to outperform those who trade less often, after taking commissions and other transaction costs into account, they would have to be a lot better at picking individual stocks. And it turns out that they're not.

There's another factor that works to reduce or eliminate the potential advantages otherwise associated with telephone hotlines: The hotlines become the catalyst for reduced discipline. As we know, discipline is

FIGURE 1. THE IMPACT OF HOTLINES ON NEWSLETTER PERFORMANCE



important because otherwise we'd be vulnerable to every whim and fashion that captures Wall Street's fancy. Without discipline, advisers and their followers are merely reactive, responding to financial news after the fact—usually too late.

In my experience, the existence of a hotline encourages an adviser to become more reactive, and thus have less discipline. Of course, not all of the services with hotlines are this way. Market Logic, for example, despite having two hotline updates each week, has more of a long-term

focus than virtually every other letter the HFD follows, including those without hotlines. But that newsletter is the exception. Most advisers who have hotlines eventually succumb to the temptation to start recommending more frequent transactions.

### CONCLUSION

The picture painted by the HFD's investment newsletter performance database is far different than what investors believe about telephone hotlines. On average, newsletters

with hotlines do not perform significantly better than newsletters without hotlines. When interpreting this conclusion, be careful not to swing to the other extreme and conclude that you should automatically avoid newsletters with hotlines. The HFD's data don't support that position either.

The bottom line: You should pick a newsletter on the basis of long-term market-beating performance. Whether or not it has a hotline should not be a factor in your decision-making. ♦

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