1995's best performers were big losers in 1994, and vice versa—a heady reminder that the best bet is to focus on long-term performance.

One-Year Rankings: Not Even a Guide for Short-Term Performance

By Mark Hulbert

Investment newsletters last year provided us with a powerful illustration of why one-year track records are an unreliable guide to future performance. Almost without exception, 1995's best performers were big losers in 1994, and vice versa. In fact, even after taking their spectacular 1995 gains into account, several of 1995's top performers still lag the market as a whole for performance over the last decade.

The evidence I will present in this article is both anecdotal and statistical. Though I'll focus my discussion on investment newsletters, the conclusions I draw are equally applicable to mutual funds, pension funds, or other money managers. Hopefully it will persuade you not to focus too much attention on the annual performance sweepstakes.

The First May Be Last . . .

For starters, consider 1994's top-performing letter among the 160 or so that are tracked by the Hulbert Financial Digest performance monitoring service: Frank Taucher's Seasonal Trade Portfolio, which that year gained an impressive 118.5% (compared to a loss of –0.1% for the Wilshire 5000's total return index). Subscribers who were lured by visions of duplicating that performance in 1995 proceeded to lose the bulk of the money they devoted to following this service.

Dramatic as this example is, it is not unique. Another is Futures Hotline/Mutual Fund Timer, edited by Craig Corcoran. This service was ranked in third place in 1994, only a couple of notches below Seasonal Trade Portfolio. Yet it also was a big loser in 1995, losing more than any other newsletter the HFD follows but for Taucher's.

This inversion of 1994's and 1995's rankings was also evident at the other extreme: 1994's losers became 1995's winners. Consider the Medical Technology Stock Letter, edited by James McCamant, which was the worst performer in 1994 among all those tracked by the HFD, with a loss of 61.3%. In 1995, in contrast, it was the best performer, with an average gain of its two portfolios of 107.7%.

A similar pattern exists for most of 1995's top performers, as shown in Table 1. The table shows the top 10 newsletters for 1995 performance among those tracked by the HFD. As you can see, their average performance last year was a gain of 64.3%, in contrast to 36.5% for the Wilshire 5000. Yet in 1994, these same 10 newsletters lost an average of 12.6%—significantly lagging the 0.1% loss that year for the Wilshire 5000.

A Roller-Coaster Ride

Another perspective on this reversal of fortunes comes from reviewing the effects of compounding: A 12.6% loss followed by a 64.3% gain produces a net two-year gain of 19.8% compounded, only modestly above the 16.8% compounded return for the Wilshire 5000. Yet in the process of achieving this modest market-beating return, you would have had to endure quite a roller-coaster ride. In fact, on a risk-adjusted basis, 1995's top performers did not beat the market over the two-year period from 1994 through 1995—their fabulous 1995 gains notwithstanding.

This should not be too surprising—the very same risk that these newsletters took in one year to achieve the high rates of return most likely hurt them in the other year.

Here is another way of thinking about this. Imagine at the beginning of 1994 that you had been given the following deal: In return for advance knowledge of which newsletters would be among the top 10 for performance in 1995 (one year later), you would have to follow those newsletters during 1994 as well as 1995. Would you have taken this deal? My guess is that many of you would have. But with the benefit of hindsight, we see that this would not have been such a wise decision.

Statistical Evidence

But the evidence for the reversal of fortunes between 1994 and 1995 isn't just anecdotal. The correlation between news-

Mark Hulbert is editor of the Hulbert Financial Digest, a newsletter that ranks the performance of investment advisory newsletters. It is published monthly and is located at 316 Commerce St., Alexandria, Va. 22314; (703/683-5905).This column appears quarterly and is copyrighted by HFD and AAII.

Table 1.
Newsletter Performance: The Top 10 for 1995

		Annual Total Return		
Telephone	Newsletter*	1995 (%)	1994 (%)	2-year average (%)
(510) 843-1857	Medical Technology Stock Letter	107.7	–61.3	–10.3
(310) 587-2410	Prudent Speculator	76.4	–13.1	23.8
(708) 801-4766	The Oberweis Report	71.5	–8.5	25.3
(800) 955-9566	OTC Insight	71.2	–11.4	23.2
(800) 477-3400	The Ground Floor	55.8	–2.3	23.3
(415) 726-8495	California Technology Stock Letter	55.3	6.9	28.9
(508) 745-5532	The Cabot Market Letter	55.1	–6.7	20.3
(804) 877-5979	The Bowser Report	53.6	–8.4	18.6
(800) 634-6790	Fund Kinetics	50.9	–8.9	17.2
(216) 668-2814	Vector Vest Dividend Advisory	45.2	n/a	n/a
	Average of above 10 newsletters	**64.3**	**–12.6**	**19.8**
	Wilshire 5000 total return index	**36.5**	**–0.1**	**16.8**

Source: The Hulbert Financial Digest

**Ranking based on an average of portfolios in the event more than one is recommended.*

Table 2.
Correlation Among Rankings*

Rankings Compared	Correlation
1981-1982	0.19
1982-1983	0.32
1983-1984	–0.16
1984-1985	–0.08
1985-1986	0.13
1986-1987	0.25
1987-1988	–0.20
1988-1989	0.14
1989-1990	0.07
1990-1991	–0.12
1991-1992	0.51
1992-1993	0.06
1993-1994	–0.10
1994-1995	–0.09

**1.0 indicates perfect correlation, with a ranking one year the same as the following year; negative correlations indicate an inverse relationship—a high ranking one year and a low ranking the following year.*

letters' 1994 and 1995 rankings was negative. And this indicates that for the entire list of newsletters the HFD follows, there was an inverse relationship between their 1994 and 1995 ranks.

Nor is this result a fluke. Take a look at Table 2, which reports how closely the rankings correlated for each of the last 14 years. The figures indicate the extent to which there was a correlation between one year's ranking of newsletters and the ranking of those same newsletters in the previous year; a figure of 1.0 indicates the rankings were perfectly correlated (the same ranking each year); negative correlations indicate an inverse relationship—a high ranking one year and a low ranking in the other year. Notice that in six of the 14 years, the correlation was negative.

To be sure, the more significant pattern to emerge from Table 2 is that the coefficients are quite small, regardless of whether or not they were positive or negative.

Statistically speaking, one-year rankings have virtually no ability to predict future performance.

Focus on the Longer-Term

Both the anecdotal and statistical evidence thus point to the same conclusion: You should pick an adviser on the basis of performance over much longer periods than one year. Five years is probably the minimum period over which you should judge and compare performances. But you should focus on longer periods if and when data is available. For that reason, Table 3 reports the top 10 performing newsletters over the last decade among those tracked by the HFD, show-

Table 3.
Newsletter Performance: The Top 10 Over 10 Years

Telephone	Newsletter*	Annual Total Return: 1995 (%)	Annual Total Return: 10-year average (thru 12/31/95) (%)
(702) 831-1396	MPT Review	25.0	24.5
(415) 726-8495	California Technology Stock Letter	55.3	20.3
(818) 346-5637	Fundline	35.6	15.7
(800) 634-3583	The Value Line Convertibles Survey	16.9	15.5
(310) 596-2385	The Chartist	24.1	15.2
(619) 459-3818	Investment Quality Trends	26.0	14.4
P.O. Box 133, Redding, CT 06875	BI Research	44.4	14.2
(800) 442-9000	The Insiders	30.9	13.8
(800) 442-9000	New Issues	27.7	13.5
(800) 634-3583	The Value Line Investment Survey	20.9	13.4
	Average of above 10 newsletters	**30.7**	**12.5**
	Wilshire 5000 value weighted total return index	**36.5**	**14.2**

Source: The Hulbert Financial Digest

**Ranking based on an average of portfolios in the event more than one is recommended.*

ing also how those newsletters did in 1995.

Notice in the table that, though all 10 newsletters performed creditably last year, eight of them underperformed the Wilshire 5000.

Let this be a lesson to focus on the long term. Ask yourself the following question: If you had to make a decision between investing in a top performer over the last year and a top performer over the last decade, which would you choose?

Once the question gets asked, of course, the answer is obvious.