INVESTMENT NEWSLETTERS

How do investment newsletters stack up in their bond fund recommendations? On average, not so hot.

Timing and Selection Within the Bond Market: A Look at the Record

By Mark Hulbert

When I mention market timing and mutual fund selection to a group of investors, most think I'm talking about the stock market. And that's odd: There are more bond mutual funds in existence today than stock funds, and the average investor has more invested in fixed-income vehicles than equities. If anything, therefore, investors ought to be more interested in bonds than stocks.

The situation is changing, however. Over the last decade a number of investment newsletters have inaugurated timing systems and portfolios that focus exclusively on the bond market. In this article, I'll review their records.

Bond Market Timing

Let's first take a look at newsletters' attempts to time the bond market. The Hulbert Financial Digest performance monitoring service measures their timing abilities by constructing hypothetical portfolios based on their timing signals. These hypothetical portfolios alternate between two possible investments—a bond market index and cash—so the sole source of differences in performance will be the timing of their signals to move into and out of the bond market.

Table 1 reports the five-year gains of all those newsletters for which the HFD tracks bond-timing signals. Notice that the majority of the newsletters didn't beat the 7.5% annualized return of a buy-and-hold-the-bond-index strategy. In fact, only five did so out of the 30 strategies for which the HFD has five years of data.

The results are somewhat more favorable on a risk-adjusted basis, where eight of the 30 beat a buy-and-hold. This improved risk-adjusted result is due to the fact that some of the newsletters achieved their below-market returns with such dramatically lowered risk that they ended up ahead of the market when performance is adjusted for risk.

How dismal are these results? It depends on your perspective. If you are picking a bond timer at random, for example, then these results are quite discouraging: They suggest that you'll do better by not trying to time the bond market. However, there is no reason to pick your bond timer at random. If you pick your newsletter from among those with the best long-term records, your chances of success—though not assured, by any means—are significantly higher.

Another perspective comes from comparing the bond market timers in Table 1 with stock market timers. In aggregate, bond timers have fared no worse than stock market timers. For example, over the last five years, just eight of the 116 stock market timers the HFD tracks have beaten a buy-and-hold strategy. That is just 7% of the stock timers, in contrast to 17% of the bond timers. On a risk-adjusted basis, 25 of the 116 (22%) stock market timers equal or exceed the market's return—in contrast to 27% of the bond timers. So there's no reason for the bond timers to hold their collective heads in shame over this result: It's no better for stock timers either.

Bond Fund Selection

So much for bond market timing. How do the newsletters fare when it comes to selecting particular bond mutual funds? For answers, take a look at Table 2.

Table 2 reports the performance of a selected group of newsletters that maintain specific model portfolios of fixed-income funds. However, simply comparing a newsletter's performance to the market itself does not reveal whether its selection advice adds value, since a number of these newsletters engage in both bond market timing as well as bond fund selection. Table 2, therefore, attempts to isolate from each newsletter's overall record the portion attributable to timing advice and the portion attributable to selection.

The first column in Table 2 reports the portfolios' actual performances as

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Table 1.
Bond Timing Performances*
5 Years Through 8/31/96

Newsletter—Timing System	5-Year Annual Return (%)	Return Per Unit of Risk**
Fund Exchange—Bond Model	9.06	0.35
Professional Tape Reader—Bonds' Major Trend—No Shorting	8.75	0.34
Systems & Forecasts—LT Bond Model—No Shorting	8.12	0.28
The Dines Letter—Major Bond Model—No Shorting	7.72	0.27
Timer Digest—Bond Consensus—No Shorting	7.60	0.25
Bob Brinker's Marketimer—Bond Model	7.50	0.20
Mutual Fund Strategist—Bond Model	7.47	0.25
Investor's Intelligence—Bond Portfolio	6.49	0.19
Professional Tape Reader—Bonds' Major Trend—Shorting on Sell Signals	6.35	0.13
Big Picture—Bond Model—No Shorting	6.11	0.17
Professional Tape Reader—Bonds' ST Trend—No Shorting	6.08	0.15
Futures Hotline—Long-Term Asset Allocation Model	5.94	0.33
Futures Hotline—Asset Allocation Model	5.79	0.26
Professional Timing Service—Rydex Switchers—No Shorting	5.68	0.15
Systems & Forecasts—LT Bond Model—Shorting on Sell Signals	5.65	0.09
Marketarian—Bond Model	5.21	0.09
PQ Wall—No Shorting	4.56	0.03
Timer Digest—Bond Consensus—Shorting on Sell Signals	4.32	0.01
Income & Safety	4.29	0.01
Elliott Wave Theorist—No Shorting	4.28	0.00
The Dines Letter—Bond Model—Shorting on Sell Signals	4.09	0.00
Addison Report—Bond Mutual Fund Allocation	4.07	–0.03
No Load Mutual Funds Selection & Timing: No Shorting	3.97	–0.03
No Load Mutual Funds Selection & Timing: Shorting on Sell Signals	1.57	–0.22
Big Picture—Bond Model—Shorting on Sell Signals	0.93	–0.19
Professional Tape Reader—Bonds' ST Trend—Shorting on Sell Signals	0.40	–0.22
Professional Timing Service—Rydex Switchers—Shorting on Sell Signals	–0.46	–0.28
PQ Wall—Shorting on Sell Signals	–1.10	–0.34
Futures Hotline—Intermediate Term Model—Shorting on Sell Signals	–5.37	–0.60
Elliott Wave Theorist—Shorting on Sell Signals	–9.57	–0.61
Average	**4.18**	**0.04**
Shearson Lehman Hutton All-Maturities Treasury Index	**7.50**	**0.20**
90-Day T-Bills	**4.28**	**0.00**

**In calculating these gains, the HFD used the Shearson Lehman Treasury Index as the proxy for the bond market as a whole—a total-return index that is a composite of all U.S. Treasury securities of one year in maturity or longer. All cash positions were credited with the 90-day T-bill rate.*

*** Return per unit of risk is measured by the Sharpe Ratio—the average monthly performance above the T-bill rate per unit of risk.*

calculated by the HFD, while the second column reports their timing-only performance (using the same method in Table 1), and the third column reports the performance of a buy-and-hold approach in a bond index fund. The fourth column is the value added by a newsletter's timing—the timing-only performance (column 2) less the buy-and-hold-an-index fund performance (column 3); the fifth column is the value added by its selection advice—the actual performance (column 1) less the timing-only performance (column 2) (unless the fund does not attempt to time the market, in which case a buy-and-hold-the-index performance is subtracted from actual performance.

The averages at the bottom of Table 2 indicate that, on average, the selection advice provided by this group of newsletters ended up costing their portfolios about 23 basis points a year—in other words, these newsletters would have made 0.23% more per year if they had concentrated solely on market timing and used a bond index fund as the vehicle for their investment decisions.

This 23-basis-point annual loss due to selection advice, by the way, is above and beyond the 93-basis-point loss annually due to timing decisions. It is important to note, however, that only some of the newsletters in Table 2 actually engaged in market timing, so the sample size here is fairly small. For the larger sample size in Table 1, in contrast, the average yearly cost of market timing was 332 basis points.

Of course, up until now I have focused on newsletters on average. But this blurs the distinction between the best and worst performers. For example, the selection advice from Hussman Econometrics Fixed Income portfolio added nearly 5.4% per year. On the other hand, the selection advice from the Value Line Mutual Fund Survey's portfolio of "Highest Ranked Taxable Fixed Income" funds cost the portfolio nearly 5.4% per year.

Are the results discouraging? If you pick a newsletter at random, you would be better off investing in a bond index fund and adopting a buy-and-hold approach. But there are clear differences among newsletters, and if you choose among the ranks of the best performers, your odds are better than random.

Asset Allocation

The results the HFD has found with investment letters fit in nicely with the conclusions of numerous academic studies about the importance of asset allocation. In general, those studies have arrived at two major conclusions: First, they found that asset allocation

Table 2.
The Relative Contributions of Market Timing and Fund Selection in the Bond Market
(All percentages annualized)

		Annual Performance (%)			Value Added (%)		HFD
Newsletter	**Portfolio**	**Actual**	**Timing Only***	**Buy-& -Hold-the-Index****	**By Timing (col. 2 – col. 3)**	**By Selection (col. 1 – col. 2)†**	**Data Begin**
Bob Brinker's Marketimer	Fixed-Inc Model Mutual Fund Port	6.51	7.89	7.89	0.00	–1.38	Jan-91
Fidelity Monitor	Income Model	7.95	6.36	6.36	0.00	1.59	Jan-92
Financial World	Corporate Bond Fund Portfolio	7.64	n/a	7.89	n/a	–0.26	Jan-91
Financial World	US Gov't Bonds Fund Portfolio	5.20	n/a	7.89	n/a	–2.70	Jan-91
Fund Exchange	Fixed Income Bond Fund Port	10.91	8.98	9.63	–0.66	1.93	Jan-85
Hussman Econometrics	Fixed Income Portfolio	9.00	3.65	4.44	–0.79	5.36	Jan-94
Income Fund Outlook		4.88	4.48	7.89	–3.41	0.39	Jan-91
Investor's Guide to Closed-End Funds	Managed Portfolio II: Income	5.45	6.29	8.00	–1.71	–0.84	Jan-90
Investors Intelligence	Fidelity Bond Fund Switch Port	8.64	7.00	7.89	–0.89	1.64	Jan-91
Morningstar Closed-End Funds	Corporate Bond General	4.80	n/a	4.44	n/a	0.36	Jan-94
Morningstar Closed-End Funds	Government Bond	1.91	n/a	4.44	n/a	–2.53	Jan-94
Morningstar Mutual Funds	Corporate Bond Funds	5.01	n/a	6.12	n/a	–1.11	Jan-93
Morningstar Mutual Funds	Government Bond Funds	3.69	n/a	6.12	n/a	–2.43	Jan-93
Sound Mind Investing	The Schwab 100 Bond Portfolio	6.17	n/a	6.12	n/a	0.05	Jan-93
Sound Mind Investing	The Vanguard 100 Bond Portfolio	5.71	n/a	6.12	n/a	–0.41	Jan-93
United & Babson Investment Report	Income—Taxable Funds	8.79	n/a	8.61	n/a	0.19	Jan-86
The Value Line Mutual Fund Survey	Highest Ranked Taxable Fixed Inc	–0.95	n/a	4.44	n/a	–5.39	Jan-94
Vantage Point	The Income Investor	7.49	6.12	6.12	0.00	1.37	Jan-93
				Averages:	**–0.93**	**–0.23**	

** Timing-only performance is calculated by investing in a bond index fund or Treasury bills based on the timing advice provided by the newsletter.*
*** Buy-and-hold-the-index performance is calculated by investing in a bond index fund over the time period measured.*
† For newsletters that do not time the market, value added by selection is col. 1 – col. 3.

accounts for well over 90% of the variance in the long-term performance of portfolios. Second, they found that while market timing and selection decisions on average detract from their portfolios' performances, their impact on overall portfolio performance is quite small—less than 10% of the variance in those portfolios' long-run performances.

Those studies, as well as the HFD results, suggest that the most important decision an investor makes is his portfolio allocation. In the bond market, this means that it is far and away more important to decide how much to allocate to the bond market than it is to be a good market timer or fund selector within the bond arena.

You would do well to keep this overall perspective in mind as you decide whether to follow the lead of an investment newsletter or stick with a bond index fund.