How are my stock picks doing—or my adviser?

Many people try to outsmart the market by picking their own stocks. Some do elaborate analyses. Some have computer programs with multiple displays that track characteristics seconds after they are reported. Some just happen to pick up a news article that promotes the future of a company. Some turn the job over to an agent or adviser.

I have a number of friends that do any or even most of the above. They are unwilling to do the simple test I ask of them. Of the few that did, one wrote me that he didn't quite do as well as the S&P 500 stock index.

Do you know what that means? The S&P 500 index does not account for dividends that may add several percent to the returns. So, he was not doing as well as a simple low cost S&P 500 index fund which invests in all 500 stocks and ***reinvests the dividends***. Thus its ***total*** return should be higher than the index growth itself. If it's not, then the fund is taking out high fees.

One family friend has turned over all of her investments to a broker who I am convinced is robbing her. Still, she is so friendly with the broker that she is afraid to ask the questions I suggest. What are his fees? What are the expenses of her funds and have they front or rear-end fees? Does he get 12(b)1 kickbacks? How has her stock performance compared with simply buying a low cost stock index fund?

The last question is the crucial one. The test is so simple that all stock pickers and those who rely on advisers should do it. If they have Microsoft's Excel on their computer, they can use the free Return Calculator from www.analyzenow.com. This does an accurate assessment and even allows them to compare the results of their total portfolio including bonds to appropriate index funds.

Those who don't have Excel can still check the performance of the stock part of their portfolio with the simple calculation below. This is not as accurate as the computer version if a large withdrawal or deposit was made near the beginning or end of the year, but it is accurate for uniform monthly deposits or withdrawals. This works only for a whole year and not for multiple years. The analysis must be done on each year separately. Both deposits and withdrawals in the equations below are annual amounts.

Before-tax return as a percent = 100 x A divided by B
A = [Ending balance] – [Beginning balance] – [Deposits] + [Withdrawals]
B = [Beginning balance] + 0.5 x [Deposits] - 0.5 x [Withdrawals]

The calculation gives before-tax returns even if the withdrawals were to pay taxes on the returns. One *Wall Street Journal* columnist reported my analysis incorrectly saying that you would get after-tax returns if you entered taxes on returns as a withdrawal. That is not true.

OK, so here is the test. Look up the one year total return of a low cost S&P index or total stock market index fund for the previous year. For example, Vanguard's S&P 500 or Vanguard's Total Market Index fund on https://personal.vanguard.com/us/funds/vanguard/all?reset=true&mgmt=i or Fidelity's Spartan 500 Index or Fidelity's Spartan Total Market Index on http://fundresearch.fidelity.com/mutual-funds/category-performance-annual-total-returns/STKIDX?refpr=zwycbindex100.

If your own performance isn't significantly better than one of these comparisons, why not just invest in a simple low-cost index fund or even a mix of them? You are likely to get better performance without continually checking the market and trying to figure out what the future may hold—something that even 80% of the pros don't get right.

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www.analyzenow.com