

## **Is It Possible to Predict All-Stars?**

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In this year's Major League Baseball All-Star game, 13 starters were making their first All-Star appearance. Based upon three month's of performance, fans hear commentators predicting these players' continued successful performance through the years. A few players are even considered to be the next Ruth, Mantle or Mayes. History shows that most of these stars are actually the falling variety; after a brief good run of performance, they crash back to reality.

The same phenomenon takes place with mutual funds and stocks. "Top 10", "Top 50" and "Top 100" lists across the country feature performers with the highest annual return for the current year. For many lists, a mutual fund or stock need only post a few good quarters to be rendered an "All-Star." But history shows the biggest winners don't make the list two years in a row; in fact, they are more likely to be featured on the "loser" lists in consecutive years. Investors need to ask themselves if this year's All-Stars will ever be All-Stars again.

Studies have illustrated the tendency for investment All-Stars to top a list only once. Micropal compared mutual funds from the 1980s and the 1990s. The Top 20 mutual funds (out of 583) of the 1980s had an average ranking of 187 by the end of the 1990s. For those who suspect the funds ranking 11-20 might be bringing funds 1-10 down, the Top 10 funds of the 1980s had an average ranking of 183 by the end of the 1990s. Only two funds in the 1980s Top 20 stayed in the 1990s Top 20.

Mutual funds are not alone in this phenomenon. In 2001, the asset class with the best return was domestic small cap value, which went up 21.47%. Investors who put all their assets in small stocks or funds expecting All-Star performance were disappointed; the asset class lost 13.98% in 2002.

The above examples are not exceptions, they follow the rules of statistics. Specifically, statistics says in a series of results such as annual returns, you cannot use one data point to predict which data point will come next. Further, each year's return is independent of any other year's return, which makes using last year's All-Stars to predict next year's a futile effort. The true way to find a good investment is to look at its long term track record and its strategy for the future. True All-Stars are not hot one year and cold the next. Rather, they provide steady performance over the long run.

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