

Mini-Lesson: Why Stock Indices are Hard to Beat

This is an excerpt from "Serial Economic Murder" by the Mogambo Guru, 9/9/02, www.dailyreckoning.com. The Guru begins by quoting yet another writer, then completes the thought with his own comments. As you can tell from his writing "tone," he's not impressed for what passes as "knowledge" today either.

"Gary North wrote an interesting reminder of how stock indexes are re-jiggered. "Here is what is rarely discussed publicly. All stock market indexes are rigged. They are constructed in terms of the corporate survivors. The index-makers don't keep low-performing companies in their indexes. They surely don't keep bankrupt companies in their indexes. Every few years, a few underperforming stocks are dropped, and others are added.

"The abandoned stocks get sold, and the replacement stocks get bought because (1) a buy-and-hold strategy produces poor results, and (2) random-walk investing produces poor results."

"There you have the philosophy of indexes, the ones that are trotted out to show you how the S&P500, as an example, is always doing so well over any period of time.

Once again, Wall Street has shown us the way. It is incumbent upon us to get with the program here. You can easily show that your kids are all above average, just like in Lake Woebegone, if you will merely take the underperforming laggard brats out into the back yard and kill them. Then, kidnap somebody else's kid that shows more promise, to replace the worthless kids you just got rid of. ... Man, somebody ought to write this stuff down! When I think of all the years I wasted by not following this invaluable, brilliant advice..."