

IN THIS ISSUE

- Investment Newsletters Rarely “Beat” the Market
- Antitrust and Higher Education: Was There a Conspiracy to Restrict Financial Aid?
- Defense Cuts Boost Unemployment More Than Expected

Investment Newsletters Rarely “Beat” the Market

Hundreds if not thousands of investment newsletters promise to help investors outperform the stock market. They are promoted heavily and widely distributed. Their authors appear on TV shows and are quoted in magazines and newspapers. In a new study for the NBER, **John Graham** and **Campbell Harvey** ask whether investment newsletters such as these have any value. The answer, they conclude, is: very little.

In **Market Timing Ability and Volatility Implied in Investment Newsletters’ Asset Allocation Recommendations** (*NBER Working Paper No. 4890*), Graham and Harvey analyze the advice contained in a sample of 237 investment strategies recommended by newsletters over 1980–92. The authors focus on the ability of letters to recommend investment weights for cash and equity—in effect the ability to predict the direction of the market, instead of concentrating on specific equity recommendations. While many academic researchers have studied the performance of mutual funds, Graham and Harvey are the first to analyze the information contained in investment newsletters.

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turns than an investor would have gotten by merely buying and holding a passive portfolio with the same volatility of returns as is implicit in the newsletters’ recommendations. In addition, the newsletters’ ability to time the market (forecast changes of direction) is unimpressive. The newsletters rarely suggest increasing the equity share of the portfolio before the market goes up, or reducing the equity weights before the market falls. Some recommendations are remarkably poor. One high-profile newsletter produced an average annual loss of 0.4 percent over the past 13 years, compared to a 21

percent annual gain for the equal volatility strategy of investing in the S&P 500 Index futures and a riskless money market deposit.

letter performance—that is, that past performance is a predictor of future performance. However, past performance is almost always poor. They also calculate the expected market return implied by the newsletters’ recommendations, and find that the newsletters offer little information about the directions or the magnitude of market returns.

Graham and Harvey conclude that in most cases, the newsletters do not provide any information over and above that which is publicly available. The exception is a kind of information of more interest to researchers than to most investors: the authors find that in-

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percent annual gain for the equal volatility strategy of investing in the S&P 500 Index futures and a riskless money market deposit.

The authors find that there is significant persistence in investment

creased disagreement among the newsletters predicts both higher trading volume and increased volatility, a result suggested by theoretical models. RN

Antitrust and Higher Education: Was There a Conspiracy to Restrict Financial Aid?

In 1991, the Antitrust Division of the U.S. Department of Justice accused MIT and the Ivy League schools of engaging in a conspiracy to fix the prices they charge students who receive financial aid by agreeing to give the same aid package to commonly admitted students. That is, every student admitted to more than one of these

Carlton, Gustavo Bamberger, and Roy Epstein find no evidence that the schools' agreement affected the average price paid by students. Using data from over 150 schools over a seven-year period, including schools that did not participate in any "overlap" agreements on financial aid, they show that "overlap" membership had no

firms, such as MIT and the Ivy League schools (so-called because they are organized under IRS Regulation 501 (c)(3) that prevents the disbursement of any excess revenues over costs), are intended to perform some valuable social goal that is presumably not achievable through the competition of profit-maximizing firms. The evidence does not support the proposition that the schools' conduct raised the schools' aggregate revenues or decreased aggregate output. If there are no effects on aggregate revenues or output, then the achievement of a desirable social goal can provide a defense of MIT's conduct under existing antitrust precedents. Thus, the paper concludes, in the absence of adverse aggregate price or output effects, it is appropriate for the courts to consider nonprofit institutions' justifications for collective action (in this case, to enable the poor to attend school) under a Rule of Reason.

The Court of Appeals overturned the U.S. District Court's guilty verdict, citing the failure of the District Court to consider the social justifications for MIT's actions. The government reached a settlement with MIT soon thereafter that allows MIT to engage in most of the conduct that the government challenged.

"[T]he evidence does not support the government's contention that the schools' collective financial aid activities increased the schools' revenues."

schools (students who "overlapped") receiving financial aid would face the same "price" at each school. The Antitrust Division claimed that these "overlap" schools conspired in an effort to reduce aid and to raise their revenues. The schools justified their cooperative behavior by explaining that it enabled them to concentrate aid on only those in need, and thereby helped the schools to achieve their goals of need-blind admission coupled with financial aid to all needy admittees.

In **Antitrust and Higher Education: Was There a Conspiracy to Restrict Financial Aid?** (*NBER Working Paper No. 4998*), **Dennis**

statistically significant effect on average price paid. This result is stable over the entire time period for which data were available, and robust to various specifications. There was no allegation or evidence that the overlap agreements affected aggregate output at the overlap schools. Thus, the evidence does not support the government's contention that the schools' collective financial aid activities increased the schools' revenues.

The three authors also analyze the appropriate application of the antitrust laws to not-for-profit institutions. Not-for-profit "501 (c)(3)"

Defense Cuts Boost Unemployment More Than Expected

Cuts in defense spending are boosting the number of jobless in the United States above what it otherwise would be, according to a recent NBER study by **Mark Hooker** and **Michael Knetter**. In **Unemployment Effects of Military Spending: Evidence from a Panel of States** (*NBER Working Paper*

No. 4889), they estimate that the reduction in military procurement spending is adding between 0.1 and 0.2 percentage points to the unemployment rate for 1994 and 1995. Since procurement cuts constitute only about half of the current drawdown in military spending, the total decline in defense ex-

penditures may contribute as much as 0.2 to 0.4 percentage points to the national unemployment rate.

The downsizing of the military amounts to a 3 percentage point reduction over a 10-year period in defense spending's share of Gross Domestic Product, the output of goods and services in the nation.

According to studies by the Congressional Budget Office and the Defense Conversion Commission, this planned drawdown will reduce annual growth in output by about 0.25 to 0.5 percentage points from 1993 to 1995. This would imply an increase in unemployment of only about 0.1 to 0.2 percentage points per year. However, some other studies have shown that changes in military spending, such as those associated with the buildup to the Korean and Vietnam Wars and the drawdown afterward, have had larger effects on the economy.

There is also a strong correlation between the geographic distribution of increases in unemployment during the recent recession and the distribution of defense spending. Four of the states most heavily dependent on defense purchases—Connecticut, Virginia, Massachusetts, and California—experienced

a combined rise in unemployment that was over two-and-one-half times the increase in the rest of the United States in the four-year period ending in September 1992.

the economy as a whole. Because workers in the defense industry can migrate across state borders, the state-level analysis probably underestimates the aggregate im-

“[T]he total decline in defense expenditures may contribute as much as 0.2 to 0.4 percentage points to the current national unemployment rate.”

The Hooker-Knetter study uses unemployment data for each state between 1963 and 1992, and real military contract awards per capita for each of the 50 states and the District of Columbia. The Defense Department database includes all prime contracts in excess of \$25,000. This combination of data provides a greater number of observations, and greater variations in those data, than aggregate data for

DRF
pact of procurement spending on unemployment, the authors note.

A key finding of the paper is that large defense procurement cuts cause proportionately larger increases in unemployment rates than do small cuts. In other words, a cut of \$1000 per capita would put more than twice as many people out of work as a cut of \$500 per capita. DRF

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