From the Editor

Investors today are faced with an abundance of investment vehicles and a bewildering number of claims made by the vendors of these vehicles. Individuals are urged to purchase mutual funds or variable annuities based upon a variety of performance measures including alphas, betas, and five and ten year compounded annual returns. Some vendors tout investment "systems", such as dollar cost averaging, as best meeting the investor's needs.

The four articles in this issue call into question many of these claims. The first article, "A Multicriteria Approach to Mutual Fund Selection," by Kevin Hebner and Wade Cook looks beyond a fund's risk-adjusted rate of return. They suggest a multicriteria methodology matches a set of fund attributes to the preferences of the individual. These attributes include such things as front and back-end load fees, the level of diversification, the quality of service and the standard deviation of the fund's alpha.

The second article, "Active Asset Allocation Decision of Professional Equity Managers," by Robert Brooks, Haim Levy and Robert Radcliffe, is related in that it tells us not to trust a single measure of a managed portfolio's risk, notably its beta. The widely reported time series beta is found to be a poor predictor of a portfolio's current equity risk exposure since active and passive asset allocation will change that beta from one quarter to another. They recommend that investors be given the fund's current cross-sectional beta as well since this best describes the market risk of the current portfolio. Incidentally, this information is already supplied to the sophisticated consultants of large investors such as pension funds.

The third article is "Long-Run Returns on Stock and Bond Portfolios: Implications for Retirement Planning" by Kirt Butler and Dale Domian. Since retirement funds are accumulated and disaccumulated over long periods of time, the authors look at the effect of time diversification on the choice of asset classes. By resampling Ibbotson data they find, for example, that over a 30 year period of accumulation, the probability that corporate bonds will outperform common stocks is less than 4 percent. This type of information is critically important to individuals who are forced to make asset allocation decisions about their pensions with little substantive guidance.

The fourth article "Nobody Gains from Dollar Cost Averaging," takes on one of the most cherished and widely advertised investment techniques recommended by retail brokerage firms. Written by John Knight and myself, the article contrasts dollar cost averaging with optimal rebalancing and a buy and hold strategy through graphical and empirical analysis and numerical simulation. Dollar cost averaging, even without including its high transactions costs, turns out worst for investors, but perhaps not for its promoters.

While all of the articles are academically rigorous, they also have immediately usable implications. Hopefully they will be used by the better educated financial planners as well as by financial product vendors seeking to enlarge their share of an increasingly sophisticated market.

A great deal of additional research needs to be done in the area of individual investment. We do not know, for example, the effect of mean reversion on optimal portfolio construction for the individual. Nor do we know why so many consumers purchase mutual funds and variable annuities with timing services that almost consistently underperform the indices. Little has been written about hedging purchasing power risk in retirement portfolios, particularly for those living on non-adjustable defined benefit pension plans. And what about the tradeoffs of adding an employer's stock to your portfolio in a subsidized purchase plan when you are already dependent upon that employer for your salary and pension?

This column will be used to suggest research topics in individual financial management. The editors of *Financial Services Review* are accessible and welcome calls to discuss research ideas.

—Lewis Mandell