

The Stock Market Is Not A Game -- So Why Are We Teaching Kids The Wrong Lessons?

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What if your teenage daughter came home from high school and described her day in driver's education class: "The teacher said speed was the most important thing about driving, so we had a race. I won hands down. At one point I must have been going 135 miles per hour."

This reckless philosophy lies beneath the "Stock Market Game," a so-called educational program that is inflicted upon thousands of students each year. The rules are simple: your team starts with \$100,000 in imaginary cash and uses that money to buy and sell stocks over the next ten weeks. You may leave part of your portfolio in cash, which earns 5% interest. Bonds, real estate, or other assets are not permitted. You can trade as often as you like and are charged commissions. You can even borrow money to buy stocks, for which privilege you are charged 7% interest. The winner is the team whose portfolio has the highest value at the end of 10 weeks.

The game is operated nationally by the Foundation for Investor Education, a nonprofit organization that was founded by the Security Industry Association, the trade association for stock brokerage firms.

There is so much wrong with this approach to "investor education" that I hardly know where to begin. The lesson the average student takes away from playing the game -- that successful investing depends on the correct prediction of short-term price movements of individual stocks -- is abjectly wrong. It is a myth perpetuated by SIA members and others who profit from the frequent trading of stocks. Our schools should not be drilling this myth into the next generation of investors.

To be sure, debt-free investors should be encouraged to invest in the stock market, and the younger you are the larger the percentage of your portfolio that should be in stocks. But index funds -- in which returns are tied to the performance of the stock market as a whole -- are the best bet for the vast majority of investors. Even professionally trained fund managers only perform better than the stock market as a whole about 20% of the time after factoring in the costs of their funds. The average individual investor has a somewhat worse chance than that of beating the market.

Even if you assume that students should be taught how to buy individual stocks, the stock market game is wrongheaded. It allows students to buy stocks "on margin," a dangerous practice that has bankrupted many investors but provides lucrative interest income to brokerage firms. It permits students to maintain as few as three stocks in their portfolio contrary to any reasonable concept of diversification. It encourages quick decisions about buying stocks, whereas successful investors spend weeks or months studying a company before buying its stock.

And how would you go about picking a stock? You could pick one that has been "hot," that is to say, whose price has risen quickly. The problem is, big price movements signal volatility. For every big winner in the game there is guaranteed to be someone who lost everything on a hot stock. Volatile stocks should be avoided or kept to a minimum in real life, but that attitude won't win the stock market game.

If you are still looking for a stock you could read "Fortune" Magazine, watch the television network CNBC, or call your local SIA-member brokerage firm. At any of those places you can obtain stock picks from so-called "experts." Those picks have exactly a 50% chance of being right in the ten-week term, no more and no less. The real lesson that should be taught to our students is the very antithesis of the stock market game: Picking short-term winners in the stock market is the equivalent of tossing a coin.

And how do you know when to sell a stock? Obviously any stock that loses value must be sold immediately so as not to be a drag on your ten-week performance numbers. Pity the poor hypothetical stock market game "loser" who in October 1987 put \$10,000 in a company called Microsoft. In nine weeks it was worth only \$7,000, so she sold out to buy something she thought would grow faster. This kind of impatience can destroy a portfolio, and yet it is encouraged by the stock market game. After all, brokerage firms don't make money when you simply hold on to what you already have. That \$10,000 investment in Microsoft would now be worth over \$600,000.

Compare that to the hypothetical "winner" who, in the Spring 2000 doubled his investment over 10 weeks trading in and out of stocks like Etoys.com. Encouraged by his team's victory, he inherited \$10,000 and put it all to work in a real portfolio using the same "skills" taught by the stock market game and reinforced by all the hoopla of becoming champion. Sadly, he lost everything he started out with.

Our students should be taught this basic rule: Buy an index fund. Their costs are low, they are tax efficient, and they beat 80% of actively managed mutual funds. Of course, since index funds are not particularly profitable to the brokerage firms, you probably won't find that advice anywhere in the stock market game curriculum materials.

You should only buy individual stocks if you are prepared to lose more money than someone who is invested in an index fund. If you still want to try it, here are a few lessons more important than those taught in the Stock Market Game: (1) seek independent investment advice, preferably from someone who is not trying to sell you something; (2) with your chosen professional, design an overall investment policy statement designed to meet your objectives; (3) implement that policy, including an asset allocation program that sets appropriate limits on your equity investments; and (4) never buy stocks for the short term; rather, buy stocks in financially sound companies that you intend to hold for the long term.