The Biggest Personal Finance Story of the Past 30 Years (Part 2)

Category : Are Your Best Interests the Same as the Financial Services Industry?
Published by The Skilled Investor on Aug/12/2007

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Go to Part 3 -- >>To understand what has happened to the market valuation of the financial services sector, particularly over the last 30 years, you should view Figure 4 on page 16 of the financial study by Jeremy Siegel and Jeremy Schwartz entitled: The Long-term Returns on the Original S&P 500 Firms.   Click the link to this .pdf document in the previous sentence, and a separate browser window will pop up. [Note that this is an Adobe Acrobat document on The Wharton School of Business website at the University of Pennsylvania. Be patient and let it load.] After you have studied Figure 4, then continue reading this article on *The Skilled Investor*.

By the way, in addition to the point we are making with Figure 4, the rest of this Siegel and Schwartz paper is well worth reading. This study shows that revisions of the S&P500 index over time have not enhanced the value of the index: 1) because new stocks tend to be added, when relative valuations are peaking, and 2) because of the market trading impact of index funds that must buy these newly added firms, while they jettison those that are removed from the index. In addition, this study is yet another proof that a passive, low cost, buy-and-hold strategy is superior over the long haul to all this frenetic active investing that individuals and investment funds do.   When you looked at Figure 4 of the Siegel and Schwartz paper, did anything seem stunning to you? I was stunned, when I first saw this graphic. Figure 4 shows that the Financial services sector grew from next to nothing to become about 20% of the value of the S&P 500 by 2003. No other sector grows like this. Health Care expands, but not at as high a rate as Financials. Info Tech expands over the long-term but not at as high a rate as Financials. This graphic also shows how the boom and bust of the Info Tech bubble temporarily displaced the percentage market share of all the other sectors. Beside Financials, Health Care, and Info Tech, all of the other sectors shrink in percentage terms over the 45 years of S&P 500 market capitalization percentage data that are presented in Figure 4 of the Siegel and Schwartz paper.As of July 2007, the S&P 500 Fact Sheet on the Standard & Poors website indicated that Financials currently represented 20.77% of index market capitalization. The next four largest sectors in order of percentage market capitalization are:

1) Info Tech at 15.45%, 2) Health Care at 11.67%, 3) Industrials at 11.43%, and 4) Energy at 10.79%.Concerning the Technology, Health Care, Industrials, and Energy sectors, for years, we have very often heard about:

1) Info Tech sector -- the growth, market bubble, and crash of the information technology sector with all its increasing technological marvels and productivity contributions to the world economy;2) Health Care sector -- the continually escalating costs of the U.S. health care system, the aging of the population and attendant medical costs, and the growing crisis of millions of uninsured and underinsured people;3) Industrials sector -- the continuing migration of industry manufacturing overseas with outsourcing, dramatic job losses, and huge balance-of trade-deficits; and 4) Energy sector -- the escalating price of gasoline, natural gas, and heating oil, the negative impact of energy costs on consumer spending and economic growth, and quarterly record after quarterly record of energy company profits.Yet, at the same time, the Financial sector has grown to be almost twice the value of the Energy sector in S&P500 market capitalization. Nevertheless, we have not heard a widespread media clamor about escalating financial services costs and profits. Instead, all we hear about are financial scandals related to greed, fraud, and scams. Even then, many of these scandals

have faded from memory, as securities market values have risen in recovery following the market bust. Why don't we hear about the real financial sector scandal, which is the huge, growing, and continuous wealth transfer from individuals to financial intermediaries through exorbitant visible and hidden fees and costs? The financial media rarely focuses on exorbitant financial costs. Instead, we get "perp walks" of high profile fraudsters. It is as if we can just weed out some bad apples and get back to business as usual. Catch John Rigas, Ken Lay, Martha Stewart, Dennis Kozlowski, and on and on. Walk them in handcuffs or prison fatigues before the cameras, and then everything will be okay. With regulatory and judicial slaps on the wrist, everything will be OK, if we can just stop the more visible scandals of mutual fund market timing, corporate accounting funny business, broker sales incentives, soft dollar payments, Richard Grasso's compensation, etc.Well, Figure 4 of the Siegel and Schwartz paper shows that things will not be okay after a few tweaks to the regulatory system and a few perp walks. Individuals have in the past and apparently will in the future continue to pay exorbitant banking, credit card, insurance, and securities costs. The wealth transfer will continue unabated.

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