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The Evolution of an Investor

by Michael Lewis | December 2007 Issue

Blaine Lourd got rich picking stocks. But then he realized that everything he thought he knew about the markets was wrong. And he's not alone.

VIEW SLIDESHOW

Photograph by: Art Streiber

Like a lot of people who end up on Wall Street, Blaine Lourd just sort of stumbled in. He'd grown up happy in New Iberia, Louisiana. His father had made a pile of money in the oil patch, and Blaine assumed that he too would one day eat four-hour lunches at the Petroleum Club, hunt ducks on the weekends, and get rich. His older brother, Bryan, had left Louisiana to make what seemed like a quixotic bid to become a Hollywood agent, but Bryan was gay, even if he pretended not to be. (He's now a partner at Hollywood's Creative Artists Agency.) Blaine was distinctly not gay and felt right at home in Louisiana—right up to the moment when, during his third year at Louisiana State University, the price of oil collapsed and took the family business with it. That was when he realized he had no idea what he would do with his life. His chief distinction at L.S.U. was his ascent to the post of social chairman at the Theta Xi fraternity, and while that was nothing to sneeze at, he didn't see how it qualified him to do anything else. His father, after informing him that there was no longer a family business for him to inherit, suggested that his ability to get people to like him might go far on Wall Street. That's what first got Blaine thinking. "I didn't know what Wall Street was," he says. "I didn't even know where Wall Street was." (View slideshow of Blaine Lourd.)

Really, he just wanted to be a success. How that happened, he didn't much care. So in 1987, at the peak of the bull market, he landed a job with investment firm E.F. Hutton in Los Angeles. A few weeks into Blaine's training program, E.F. Hutton collapsed following a check-kiting scandal and was sold to Shearson Lehman.

Blaine's training at Lehman consisted of a monthlong class, which focused mainly on overcoming customers' objections, and a close reading of the bible on how to peddle stocks to people you've never met: *Successful Telephone Selling in the '80s,* co-written by a Lehman managing director named Martin Shafiroff.

A well-planned presentation creates a sense of urgency. If the prospect fails to act now, he will risk a loss of some sort.

Speak with confidence and authority.

The most important part of the presentation is the close.

Blaine set a goal for himself: Reach 100 people a day by telephone. Half the time, people hung up on him, but about one in every 300 calls led to a sale. He arrived at his office at 6 every morning to make sure he got the best lead cards. Even at that hour, the place was loud and frantic. Traders' hoots and hollers screamed the firm's need to move a specific block of stock; the TV on the wall blared potentially market-moving news. He was paid on commission and driven by fear of failure. "There were a lot better salesmen than me," he says. "I just worked harder. I made more calls. And if you make more calls, you will get the sales. And it doesn't matter what you say." Most of the time, he just read from the same script as the other brokers: "Are you familiar with Warren Buffett? We have information from our sources on the Street that his next position is going to be in a company much like Cadbury Schweppes. *[Pause]* I know you're busy, but I'd like to call you once or twice in the next six months when we have a substantial idea that will make you three to 10 times your money."

When Blaine would call back 10 days later, it almost didn't matter what he said, as long as he demanded an order and then fell completely silent. "Mr. Johnson, this is Blaine Lourd from Lehman Brothers. We see Abbott Labs going to 60, and I think you need to buy 10,000 shares of Abbott Labs today."

Half the time, in the ensuing silence, Mr. Johnson would hang up. But the other half, Mr. Johnson would explain, usually pathetically, why he couldn't right then and there buy 10,000 shares of Abbott Labs. And once Blaine had a specific objection, he had an obstacle he could overcome.

I've got to talk to my wife.

"Mr. Johnson, if you're driving at night with your wife in the city, it's snowing, and you have a flat tire, do you ask your wife to go out and change it?"

I don't have the cash.

"Mr. Johnson, you have stocks in your portfolio that are underperforming. We'll take you out of them to get you into Abbott Labs."

Why Abbott Labs?

"We have it on good authority that it's Warren Buffett's next purchase."

The older brokers in the office all threw around Buffett's name, so Blaine did too. Buffett was useful because everyone knew who he was and everyone thought he had made his money picking stocks. Blaine was picking stocks just like Buffett but using different criteria. The traders in New York would accumulate a block of shares, driving the price up, and then get brokers like Blaine to unload the shares quickly at the higher price—whereupon the price would, often as not, fall. "Seven months in at Lehman, I was one of the top rookie producers," Blaine says, "but every stock I bought went down." His ability to be wrong about the direction of an individual stock was uncanny, even to him. At first, he didn't understand why his customers didn't fire him, but soon he came to take their inertia for granted. "It was amazing, the gullibility of the investor," he says. "When you got a new customer, all you needed to do was get three trades out of him. Because one of them is going to work. But you have to get the second one done before the first one goes bad."

It wasn't exactly the career he'd hoped for. Once, he confessed to his boss his misgivings about the performance of his customers' portfolios. His boss told him point-blank, "Blaine, you're confused about your job." A fellow broker added, "Your job is to turn your clients' net worth into your own." Blaine wrote that down in his journal.

Then he caught a break. He met a girl who liked him. The girl went and told a friend about him. That friend was the business manager for the Rolling Stones. One thing led to another, and the Rolling Stones handed him $13 million to invest. It was that easy. This money constituted their tour fund, and they didn't want to take any risks with it. "I went to my office manager and asked, 'What do I do with this?' And he looked at me and said, 'I dunno.'" Blaine was seriously unnerved: He knew how to sell stocks to strangers, but that skill had nothing to do with preserving a pile of capital. "All of a sudden, I got a real client," he says. "It wasn't from some cold call. I didn't want to lose the Rolling Stones' money." He decided to invest it in Treasury bills. "Right away, I'm in conflict with the firm. My colleagues gathered around this money and asked me, 'How are you going to gross this thing up?'" Meaning how would they be able to maximize their commissions. "And I said, 'What do you mean? It's in T-bills.' And they said, 'We can't make any money on this.' And that's when I said to myself, I gotta get out of here."

He quit Lehman Brothers and took a job at the Los Angeles office of Bear Stearns. But Bear wasn't any better. He says he was pressured to make transactions rather than give good advice. The stories he told himself to feel better about his career became less and less plausible. The nicest thing he could say about himself was that he hadn't broken the law. He hadn't bankrupted anyone or anything like that. But when he stepped back from his job and really looked at it, he realized that a huge amount of his time and energy went into making people feel happy about his advice when they should have been furious. The problem was the constant tension between company and client, caused by the firm's inability to know what the market or any particular stock was going to do next. "I always thought there was going to be a place where the client wouldn't be compromised and the broker wouldn't be compromised," he says. "But it was the same everywhere. It was all about getting people to transact." And these weren't bucket shops; they were Wall Street's most distinguished firms.

He gave up on picking stocks and started picking fund managers instead. He'd sell his customers not on Cadbury Schweppes but on some mutual fund that his Wall Street firm was promoting. "I thought it was better than me picking stocks," he says. "But ultimately, these guys who ran the funds were just picking stocks like I was. And they weren't any better at it." The only thing that changed was *Successful Telephone Selling in the '80s.* It now had a new title: *Successful Telephone Selling in the '90s.*

Still, he was a 29-year-old earning $200,000 a year, and he was, as he puts it, "ramping up the lifestyle." Rival firms noticed his success: He left Bear Stearns for Dean Witter, which would later become Morgan Stanley. Blaine's business grew to the point where he became somewhat famous. Name a prominent director or big-time movie star, and there was a fair chance that Blaine Lourd was giving her financial advice. He lived near the beach in Malibu, drove fancy cars, and indulged an expensive taste for young women who had moved to Los Angeles to become movie stars. He routinely ranked in the top 10 percent of revenue producers for whichever firm he happened to be working for. In his best years, he grossed more than $1 million. His father had been right: His persuasiveness and ability to get people to like him went far on Wall Street.

Only now he had a problem. He was quickly becoming the world's unhappiest man. He often woke up with a sinking feeling in the pit of his stomach; more often, he woke up with a hangover. Like a lot of his fellow stockbrokers, he started drinking too much. "Everyone I worked with had a drinking issue," he says. "Or a drug issue. You can't continually hurt people and feel good about yourself." One day, he woke up to find he was a 37-year-old late-1990s cliché: the self-loathing Wall Street salesman. He wondered what had gone wrong and began mining his journal to write a memoir. His book, which was influenced in part by a 1940 financial-industry critique, would relate the sadness of his father's financial collapse, the sorrow of leaving home, and the sordidness of his financial career:

The sole function of a stockbroker/financial consultant/investment counselor is to get customers. So how does a stockbroker go about getting customers? The best way is to be born rich. Rich guys make good stockbrokers because generally they are lazy and so can do little harm to the client's long-term financial well-being by trading in the game of chance. The next best way is to circulate among them and to convince them with a pleasing personality that you have the ability to buy everything before the big rise—and to sell everything before the big decline.

I was not rich.

One day, someone may look back and ask: At the end of the 20th century and the beginning of the 21st, how did so many take up financial careers on Wall Street that were of such little social value? Just now, the markets are roiling, money managers and investment banks are reporting disappointing returns, and people are beginning to wonder if they chose the wrong guy in Greenwich, Connecticut, to take 2 percent of their assets and 20 percent of profits. But what if the problem isn't the guy in Greenwich but the idea that makes him possible: the belief that the best way to invest capital is to hand it to an expert? As a group, professional money managers control more than 90 percent of the U.S. stock market. By definition, the money they invest yields returns equal to those of the market as a whole, minus whatever fees investors pay them for their services. This simple math, you might think, would lead investors to pay professional money

managers less and less. Instead, they pay them more and more. Twenty-five years ago, the most successful among them took home a few million dollars a year; in 2006, more than 100 money managers made more than $100 million, and a handful made more than $1 billion. A vast industry of stockbrokers, financial planners, and investment advisers skims a fortune for themselves off the top in exchange for passing their clients' money on to people who, as a group, cannot possibly outperform the market.

For Blaine Lourd, American stockbroker, the mere fact that he landed in the middle of this industry and became a success was reason enough to hate himself. But in Santa Monica, as Blaine twisted himself into ever more intricate knots to disguise his inability to pick winning stocks or money managers, his antithesis was rising. It was a firm founded in 1981 on a simple idea: Nobody knows. Nobody knows which stock is going to go up. Nobody knows what the market as a whole is going to do, not even Warren Buffett. A handful of people with amazing track records isn't evidence that people can game the market. Nobody knows which company will prove a good long-term investment. Even Buffett's genius lies more in running businesses than in picking stocks. But in the investing world, that is ignored. Wall Street, with its army of brokers, analysts, and advisers funneling trillions of dollars into mutual funds, hedge funds, and private equity funds, is an elaborate fraud.

The firm, Dimensional Fund Advisors, was co-founded by David Booth, who had worked at the University of Chicago as an assistant to Eugene Fama. As a graduate student in the early 1960s, Fama coined the phrase *efficient markets.* D.F.A. sold its clients on passive investing: Instead of looking for trading opportunities and paying stockbrokers and fund managers, D.F.A. bought and held baskets of stocks chosen for the sort of risk they represented. It didn't call these baskets index funds, but that is more or less what they were. And they—along with the idea they embodied—were growing at a sensational rate. In 1989, D.F.A. was managing $5.2 billion; by 1998, the number was up to $28 billion. Then the internet bubble burst, and even more people fled the stock-picking game. In the summer of 2007, when I visited, the firm had an astonishing $153 billion under management, $90 billion of which had come from individual investors, through a network of professional advisers.

Back in the old days, when investors believed that they were paying for some mysterious wisdom, the buildings housing Wall Street firms were stone on the outside and dark wood on the inside. Now that investors have learned to fear what they can't see, the firms are in buildings made of as much glass as can be incorporated into a structure without compromising its ability to stand. The day I arrive at D.F.A.'s offices, I find 150 financial advisers in a glass box, waiting to be educated in a seminar that lays out the D.F.A. way. The coffee and pastries are free, the men and women wear suits, and the conference room has the antiseptic feel of any other 21st-century firm. But the atmosphere is entirely different from Wall Street. There's no chitchat about the market, even though it has been bouncing around wildly. Instead, two speakers discuss how, knowing what we now know, anyone could present himself as a stock-picking guru. "If you put a thousand people in barrels and push them over Niagara Falls," one of them says, "some of them will survive. And if you take those guys and push them over again, some of them will survive. And they'll write books about how to survive being pushed over Niagara Falls in a barrel."

The other speaker paces back and forth in the well at the front of the room. "Have you seen the show *Mad Money*?" he says. "It's repulsive."

No one disagrees. That they are here, preparing to join the thousand or so converts authorized to sell D.F.A.'s funds to investors, implies their agreement. They're all salesmen, but salesmen peddling an odd idea: Don't listen to salesmen.

In the beginning, back in the 1980s, D.F.A. didn't sell to individual investors at all. The funds sold themselves by word of mouth. Finally in 1989, D.F.A., with some reluctance, agreed to allow financial advisers to steer clients' money into D.F.A. funds, but only after those advisers had demonstrated their purity of heart. They must never, ever, sell individual stocks, try to time the market, or suggest to investors that it is possible to systematically beat the market. D.F.A. required its aspiring antisalespeople to fill out questionnaires and submit to telephone interviews. If they passed those tests—which thousands failed—a team from the firm would dignify them with an office visit and grill them on their beliefs about the stock market. "One of the reasons we visit them," says Weston Wellington, one of D.F.A.'s principals, "is just to see the office. If there are TVs blaring CNBC and people running around screaming, we say, 'Wait a minute here.'" The final test of ideology is the conference. Having demonstrated sufficient cynicism about Wall Street, the financial advisers must pay their own way to Santa Monica, California, and listen to speeches that explain why, if anything, they should think even less of Wall Street than they already do.

One question naturally arises: What makes someone good at selling this curious attack on the modern financial system? I ask Joe Chrisman, the interface between D.F.A. and the thousand independent financial advisers who have qualified to sell D.F.A. funds, "Of all these proselytizers, who is the most effective at taking an investor who thinks he can beat the market and turning him into someone who quits trading and hands his money over to D.F.A.?"

"That's easy," he says. "Blaine Lourd."

When Blaine Lourd started out on Wall Street, he had a mop of dark hair and the wild smile of a Baroque painter's idea of Bacchus. He was still young, thin, and handsome, but as his career progressed, the smile changed, becoming, like his eyes, narrower and more calculating. He was turning into one of those men that old friends fail to recognize at their 20-year high-school reunions. But here was the thing: The difference between who Blaine had been and who he had become was entirely a matter of how he had set about making himself a success. He'd been raised to go through life happy, without thinking too much about it, but the career he'd chosen had proved contrary to his upbringing. He'd violated his nature, and his appearance was paying the fine.

Then something happened. In 1996, at the beginning of the greatest speculative bubble in the U.S. stock market's history, he attended Dean Witter's conference for brokers whose sales ranked in the firm's top 5 percent. There, he found himself seated beside a broker in his sixties, who struck up what Blaine says was "a cynical conversation about the state of our industry." The conference's speakers gave the usual patter about finding opportunities in the stock market, and the older fellow must have noticed Blaine straining to take it all in. "He's looking at me like, You're smart enough to know better than this. But I'm not smart enough to know better than this. And he says to me, 'You need to read Charles Ellis' book *The Loser's Game.*'"

Blaine bought the book—it's actually called *Winning the Loser's Game*—and took it with him to Aspen on his Christmas vacation. There, on the first page, he read "Investment management, as traditionally practiced, is based on a single basic belief: Professional investment managers can beat the market. That premise appears to be false."

Ellis, who had spent 30 years advising Wall Street firms, went on with charts, graphs, and more evidence than he needed to convince Blaine of the truth of that statement. The problem wasn't Blaine; the problem wasn't even the firms he worked for. The problem was the entire edifice of modern Wall Street, in which some people—brokers, analysts, mutual fund managers, hedge fund managers—presented themselves as experts and were paid fantastic sums of money for their expertise. But essentially, Ellis argued, there was no such thing as financial expertise. "I read this book," Blaine says, "and I thought, My whole life is a lie, and everyone around me is facilitating this lie."

It took him stints at three firms to figure out that Wall Street wasn't going to let him act on his new conviction. From Dean Witter he went to Oppenheimer, and from Oppenheimer he went to A.G. Edwards. "I was now an efficient-markets theorist," he says. "But there was no product for an efficient-markets theorist." At the peak of the internet boom, he sunk a bunch of his clients' money into a fund called Roxbury Capital Management, which advertised itself as a value investor. But then he noticed that Roxbury was buying big-name tech stocks after huge run-ups, and he pulled the money out. He looked around for money managers who minimized transaction costs, but when he found them, he'd discover that they weren't on the list recommended by the firm he worked for. "All these money managers were saying to us, 'Put your money with us and hold on for the long term,' but they were turning over their portfolio every quarter. *They* weren't holding for the long term." He brought up his new qualms with senior managers, but they seemed to only pretend to listen. "They knew that if they bought into efficient-markets theory, they'd break their entire belief system and ultimately collapse their revenue stream."

He was no longer cynical; he was outraged. At the end of every year, he'd circulate memos showing that 80 percent of the money managers the firm promoted to clients had underperformed the market. (An example of Blaine's market commentary: "This is a nonstop jack-off to try to predict what is going to happen.") He received no reply and realized his colleagues didn't care. So he saw their indifference and raised it: He stopped attending the lavish conferences the firms threw for top producers. "A fancy dinner, a round of golf, and a motivational speech by Wayne Dyer all about overcoming obstacles," Blaine says. "It had nothing to do with the market. It was about pumping you up and rewarding you for your salesmanship." He told his clients he shouldn't pick stocks for them or dump their money into actively managed mutual funds. Instead, he'd put it all in index funds. For this service, he took an annual fee of 1 percent of their assets. "It was working great," he says. "Everyone was happy. I was happy. The clients were happy."

A.G. Edwards was not happy. Blaine was still generating profits for his firm. Of the 6,000 A.G. Edwards brokers, he still ranked in the top 30. But for every dollar that passed through his hands, he was slicing off a surprisingly small piece for himself and A.G. Edwards. This brought a letter from the head of sales, saying that while managers appreciated how much revenue he generated, they wanted to see him generate 10 percent more. They want me to churn these accounts, he thought. He fired off an angry reply and refused to trade. A few months later, he received a visit from a local manager. It makes the Securities and Exchange

Commission unhappy, the manager said, to see brokers getting paid for doing nothing. The U.S. government wanted Blaine to churn his accounts. "At that point," he says, "I was done."

In June 2006, he quit and set up his own office in Beverly Hills. He called his new firm Lourd Capital Management and started doing from outside the established Wall Street structure what he had tried to do inside it. All but a handful of his 200 clients at A.G. Edwards left with him. He cast about looking for a home far away from Wall Street where he could put his money, and remembered a friend telling him about D.F.A. It was as if the place had been created with him in mind: an entire firm premised on the theory that all of Wall Street floats on bullshit. He called D.F.A.'s phone number. "What do I gotta do to drop a ticket today?" he asked.

That's when he learned that he couldn't join the new religion until he proved the sincerity of his faith. Before he could give D.F.A. his money, he had to fill out an eight-page questionnaire about his investment philosophy. This he did, with a feeling that "most of the questions were designed to trick you into saying something you weren't supposed to say." Next came the phone interview, which he assumed he passed, since two D.F.A. employees visited his office soon thereafter. "I sat around here answering their questions for two and a half hours," he says. "Afterward, I thought we were done, but one of them just said, 'I think we can continue with this process.' I thought, Are you kidding me? There's more? And they said, 'You gotta go to a class.'"

The show at D.F.A. breaks down roughly into two acts. Act 1 consists of speeches from impressively credentialed academics who can explain why the efficient-markets hypothesis is scientifically indisputable. The hypothesis is an odd idea with an even odder history. In 1900, a French graduate student named Louis Bachelier completed a dense thesis called *Theory of Speculation,* in which he concluded that prices follow a random walk—that is, no information about past prices enables a trader to predict future ones. Bachelier described the market as an "aggregate of speculators" who "at a given instant can believe in neither a market rise nor a market fall, since, for each quoted price, there are as many buyers as sellers." It made sense, but Bachelier's superiors thought he was either out of his mind or dealing in trivia and blackballed him for any job recommendations.

Then, nothing. For 60 years, people traded stocks happily, gave stock market advice freely, and paid brokers handsomely without anyone's uttering a peep about the theoretical futility of it all. Stock markets boomed and crashed, and financiers jumped out the windows of tall buildings. Yet it occurred to no one to pick up where Bachelier had left off. In retrospect, it's clear that an economic incentive to pursue the idea was missing. The only people who understood the stock market well enough to wonder if its efficiency made predictions irrelevant were the ones who made their living selling those predictions. But in time, the American economy grew so prosperous and complicated that it could support an industry of people who did nothing but analyze stock market prices without a view to personal profit and loss. Professors of finance, these people were called, and they made their living publishing papers on their subject for an audience of dozens.

In the early 1960s, the efficient-markets hypothesis finally took off, thanks first to Paul Samuelson, who reminded everyone of Bachelier's paper, and then to Eugene Fama, who tested it against actual U.S. market data. Fama discovered that the Frenchman had got it exactly right back in 1900: A person could learn no

useful information about future stock market prices by examining past performance. Chart reading, graph plotting, momentum analysis, and all the rest of the more esoteric Wall Street techniques for predicting stock-price movements were hokum. Fama went further: No public information at all is of any use to a trader trying to beat the market. Balance-sheet analysis, industry insight, articles in the *Wall Street Journal,* a feel for the character of a C.E.O.—these are all a complete waste of the investor's time, as what's already known is factored into stock prices too quickly to act on it, and what isn't known is inherently unpredictable. "The true news is random," says Burton Malkiel, a Wall Street banker turned Princeton professor who published the most famous book on the efficient-markets hypothesis, *A Random Walk Down Wall Street.* "That's what people had trouble grasping. It's not that stock prices are capricious. It's that the news is capricious."

The essence of the randomness message was that investors must simply accept the miraculous God-given returns of the stock market as a whole and resist the temptation to try to exceed those returns. They must never believe they possess special wisdom and judgment; the stock market has no use for human wisdom and judgment. Fama attempted to go even further. His most radical hypothesis was that an investor would not be able to profit even from private, inside information about a company. His data ultimately forced him to reject this notion, but not before he noticed how little insiders profited when they traded on what only they knew. The rest of Fama's hypotheses became academic gospel.

Forty years later, the combination of professional money managers' fantastic ineptitude and the power of Fama's argument has driven more than $1 trillion out of stock picking and into index funds. What's odd about index funds' rise is that it has occurred in spite of mounting evidence that markets aren't perfectly efficient after all. In the early 1990s, a counterview was hatched on the fringes of academic finance. How can the market be rational if all the people in it are not merely nuts, but nuts in the same way? If people are crazy enough to pick stocks, time markets, and pump up mutual fund managers who, in turn, don't know what *they're* doing, then why aren't people crazy enough to create systematic inefficiencies that smart investors can exploit? For the better part of three decades, the efficient-markets theorists brushed aside the question with a flick of the wrist: It doesn't matter if individuals are mad. If crazy people drive prices out of whack, arbitrageurs will rush in and bring them back into line.

But by the late 1990s, the question could no longer be dismissed so easily. What if the asset being mispriced—say the entire U.S. stock market—offers no obvious arbitrage opportunity? The same behavioral-finance professors who delighted in uncovering cases of human irrationality paused to point out specific mispricings that arbitrageurs failed to correct. Economists Richard Thaler and Owen Lamont penned an academic paper about the strange case of Palm and 3Com. After the companies announced an opportunity to get one and a half shares of Palm for every 3Com share, investors found themselves unable to do the math. When the market opened the next day, the firms' prices didn't come close to reflecting the deal's terms. "If the market can't multiply by 1.5," Thaler says, "then how can we expect it to get the right level of the S&P?"

And what about investors who systematically beat the market? Fama insisted that they simply don't exist. If millions of monkeys throw a bunch of darts at the *Wall Street Journal,* at least one monkey would pick a group of winning stocks.

At D.F.A.'s training seminar, the firm now offers a more nuanced pitch. "It seems to me a foolish argument," Ken French, a Dartmouth finance professor and D.F.A. board member, tells the audience of financial advisers. "Can Warren Buffett beat the market? I don't want to have that fight. Let's agree for a moment that Warren Buffett is a wonderful stock picker. And he's magnanimous. He wants to share his skill with investors. How would he do that? He can't! The value of Warren Buffett's skill is already in Berkshire Hathaway's share price." If by some miracle an investor comes along who can beat the market, it is he, not you, who will extract the value.

Now in his late sixties, Fama serves as a consultant to and board member of D.F.A., where his main role is to buttress the convictions of each new platoon of financial advisers and reinforce the idea that investors who try to pick stocks or time markets are fools. He looks and moves less like a finance professor than a retired bantamweight, but he's no longer much interested in the fight. Forty years of preaching has taught him that his audience either agrees with him or never will. And so he speaks dully, like a man talking to himself. But he makes his point. In his years of researching the stock market, he has detected only three patterns in the data. Over the very long haul, stocks have tended to outperform bonds, and the stocks of both small-cap companies and companies with high book-to-market ratios have yielded higher returns than other companies' stocks.

These are the facts. The question is how to account for them. Fama's explanation is simple: Higher returns are always and everywhere compensation for risk. The stock market offers higher returns than the bond market over the long haul only because it is more volatile and thus more risky. The added risk in small-cap stocks and stocks of companies with high book-to-market ratios must manifest itself in some other way, as they are no more volatile than other stocks. Yet in both cases, Fama insists, the investor is being rewarded for taking a slightly greater risk. Hence, the market is not inefficient. Everything else in the stock market he dismisses with a single word: *noise.* "You can tell a story every day about stocks," he concludes. "That's what the media are all about. They tell a story every day about today's stock returns. It's businessman's pornography."

Businessman's pornography, as it happens, is Act 2 of the D.F.A. show. With more than a little relish, Wellington, who gives as his credential his having a "master of anecdotal evidence," gets up and picks apart Wall Street's phony expertise and the media that feed off it. "What has been the role of the financial media?" he asks and then answers his own question with a series of damning slides. There's a shelf of financial bestsellers whose titles now sound absurd: Ravi Batra's *The Great Depression of 1990;* James Glassman's *Dow 36,000*; Harry Figgie's *Bankruptcy 1995: The Coming Collapse of America and How to Stop It.* There's *BusinessWeek's* 1979 description of "the death of equities as a near permanent condition," and *SmartMoney's* cover story "Seven Best Mutual Funds for 1996," whose selections later underperformed the market by 6.7 percent. In 1997, SmartMoney found seven new best mutual fund managers. They finished 3.4 percent below the market. In 1998, the magazine's newest best funds came in 2.2 percent below the market. Soon after, Wellington says, "*SmartMoney* stopped its annual survey of the best mutual fund managers."

He punctuates the porn show with some general lessons. One is that the financial press isn't in the business of supplying useful information; it's in the business of feeding people's lust for predictions. "You keep buying the magazine regardless of how the forecasts turn out," Wellington says, "and they'll keep supplying the

forecasts." Another is that if the best mutual fund managers can't pick stocks well, how can you? A third is that even putatively great money managers exhibit no ability to identify other great money managers. When Peter Lynch retired from his sensational career running Fidelity's Magellan Fund in 1990, his successors proceeded to underperform the market. "If you wake up in the morning and see Warren Buffett's face in the bathroom mirror," Wellington says, "go ahead and buy some stocks. If you see anyone else's face, diversify."

And on he goes, persuasively, but as he does, his comments evoke an obvious question, one that no D.F.A. financial adviser dares ask: If all financial advice is worthless and the only sensible strategy is to buy an index fund that tracks the market, why would anyone need a D.F.A. financial adviser? Why, for that matter, should anyone pay D.F.A. the 50 basis points it takes off the top of its oldest fund? D.F.A.'s answer to this is interesting: It can beat the index. The firm doesn't ever come right out and say, "We can beat the market," but over and over again, the financial advisers in attendance are shown charts of D.F.A.'s large-cap funds outperforming Standard & Poor's 500-stock index and D.F.A.'s small-cap fund outperforming the Russell 2000.

In each case, the reason for D.F.A.'s superior performance is slightly different. In one instance, D.F.A. found a better way to rebalance the portfolio when the underlying index changes; in another, it came up with improvements in capturing small-cap risk. All these little opportunities can be (and are) rationalized as something other than market inefficiency, but they are hard to exploit, even with the help of D.F.A. The lesson of efficient-markets theory is that when anyone from Wall Street calls you up with financial advice, you should be very afraid. But it isn't fear that prompts investors to embrace D.F.A. It's greed.

"It was a propaganda session," Blaine says, groping for the best analogy to describe D.F.A.'s seminar. "It was beyond A.A. It was Leni Riefenstahl, but the right way." Truth be told, for the whole two days of the seminar, he had the unsettling sense that he was being watched. He kept his head down and avoided saying anything that might cause D.F.A. to suspect he was still an ordinary stockbroker. ("Had you said, 'I think small-cap value stocks are inefficient,' I think you could get kicked out.") They weren't teaching him; they were deciding whether he believed what he needed to believe to sell their investment advice. This was new.

A couple of months after attending the seminar, Blaine succeeded in getting $100 million of clients' money into D.F.A.'s funds. He worked from his own little space in Beverly Hills, which was, in its most recognizable feature, as unlike a Wall Street brokerage firm as could be: It was completely silent. No TV blaring CNBC. No squawk box. No urgency. "There's one decision," he says. "We decide how much to allocate to various funds, and then we're done." He wonders why he would need any sort of real-time financial information at all. "What am I going to do: Chart a stock? I think more and more brokers will move to an efficient-markets strategy, because all of their products go bad. They just do." The hours he once spent obsessing over financial news, he now devotes to *SportsCenter.* Even his memoir, into which he put so much effort, is on hold. "It's funny," he says. "I don't write as much as I used to, because I'm happy now."

Last year was, by far, the biggest year of his career. The assets under his management are up 40 percent since he left A.G. Edwards. He's still making money, but his purpose in life has been turned on its head. Investors used to come to him for tips. Now the same clients come to him so he can prevent them from listening to tips—or hunches, or the latest rantings on cable TV. ("They'll call and say, 'Well, Maria Bartiromo

just said…'") His biggest problem is dealing with new prospects. "They come in here, and their funds have underperformed the market by 300 basis points, and the first question out of their mouth is 'Who's your guy?' We have to reeducate them: There is no guy. The guy is the market. The guy is capitalism."

His job, as he now defines it, is to tell investors that the smartest thing they can do is nothing. He acts as a brake on, rather than an accelerator for, their emotions. For that, he takes between one-half of a percent and 1 percent annually, which is more than they'd pay if they simply bought index funds on their own. "I tell them, 'Look, if you can control your own emotions and you want to go to Vanguard, you should do it.' And every now and then, someone asks the question, 'Why do I need you, Blaine? What are you doing?' And I say, 'Howard, be careful or I'm going to send you back to Smith Barney.' And they laugh. But they know exactly what I mean."

Blaine seems for all the world like a man who has made a separate peace. He works surrounded by large black-and-white photographs of the Louisiana bayou of his youth. If he were required to explain his career now to his 18-year-old self, he wouldn't need to apologize. Every now and then, he feels the old itch to be a player, but, as he puts it, "When I pick a stock, I do it for my own account, never for clients." He's never going to make the really big money ("This isn't a business model that funds a private jet"), but as long as his clients need him to protect them from Wall Street and themselves, his career has a higher purpose. There's a hitch, though. Like a reformed addict or an escaped prisoner, he's now defined by what he isn't rather than by what he is. What happens when what he does is no longer new? What happens when it's no longer all that uncommon?

Blaine still takes great pleasure in describing just how screwed up the American financial system is. "In a perfect world, there wouldn't be any stockbrokers," he says. "There wouldn't be any mutual fund managers. But the world's not perfect. In Hollywood, especially, people need to believe there's a guy. They say, 'I got a friend who made 35 percent last year.' Or 'What about Warren Buffett?'"

Then he pulls out a chart. He graphs for me the performance of one of D.F.A.'s value funds, which consists of companies with high book-to-market ratios, against the performance of Warren Buffett's Berkshire Hathaway since 1999. While Buffett's line rises steadily, D.F.A.'s rises more steeply. Blaine's new belief in the impossibility of beating the market doesn't just beat the market. It beats Warren Buffett.

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