Personal Finance | Lynn O'Shaughnessy
BUSINESS
`Mad Money' stock picks show success often fleeting

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Most television shows that devote themselves to stock picking are fairly staid. I'm thinking back to the old financial show hosted by Louis Ruckeyser, who chatted with his guests as if they were sitting in a drawing room sharing brandy and cigars after the dinner plates had been whisked away.

That's not what you get if you tune into "Mad Money" on CNBC. Mad is a good word to describe the show since its host, Jim Cramer, is the sort of guy who could make Godzilla look sedated. During the weeknight show, the former hedge fund manager bites the heads off toy bulls and bears, and he barks out orders on whether to buy or dump stocks while studio lights flash and heavy metal music pulses in the background.

After watching this guy pacing for an hour, I was exhausted. I couldn't help wondering how he could keep going without ever collapsing into a chair. But the question that viewers should be asking is this: Can you make money by chasing Cramer's hyperkinetic stock picks?

Three doctoral students at the Kellogg School of Management at Northwestern University recently took a stab at that question. In a paper entitled, "Is the Market Mad? Evidence from Mad Money," the trio concluded that the profits Cramer's viewers enjoy typically sour quicker than the carton of milk in your refrigerator.

It's understandable why the televised circus should attract the attention of the students. "Mad Money" is CNBC's most popular show, attracting more than 380,000 viewers every weeknight. Within that audience are a lot of investors, who are eager to throw cash at blue chips as well as obscure companies that may sell swimming pool supplies, pave toll roads or make money doing stuff we couldn't even imagine. These viewers presumably have concluded that taking their cues from Cramer beats flipping coins, consulting tea leaves or throwing darts at the newspaper stock listings.

The researchers, Joseph Engelberg (a San Diego native and a 1998 graduate of Horizon High School), Caroline Sasseville and Jared Williams, recorded the 246 initial stock recommendations that Cramer made between July 28, 2005, and Oct. 14, 2005. The three acknowledged that divining just what constituted a buy recommendation wasn't easy. They had to grapple with how to pigeonhole Cramer's pronouncements. When I watched an episode last week, for instance, Cramer expressed his enthusiasm for a defense stock by blurting out -- "I would back up the truck on this." When discussing a medical software company, he proclaimed, "I think it's time to ring the register. ... I'm feeling too hoggish." Not sure, how to decipher that one.

In resolving this issue, the trio pulled the televised recommendations that were subsequently recorded on YourMoneyWatch.com, which has kept a running tally of Cramer's picks since July 28. According to the Web site, Cramer's stocks have collectively climbed 8.74 percent. In comparison, the Standard & Poor's 500 Index has increased 4.76 percent and the Nasdaq Composite Index 6.34 percent

What the researchers documented was an eagerness by investors to swallow Cramer's bait. The show is recorded 30 minutes after the markets close, but by the next morning, the highlighted stocks encounter a sudden rush of popularity. In fact, the volume for these stocks remained abnormally high for three days. This intense burst of interest pumped up the prices of the featured stocks. The price pop was often quite significant. The smallest stocks among those recommended -- those in the bottom quartile by size -- typically jumped 5.19 percent overnight. The price rise for the entire sampling, which included large corporation stocks that are harder to move, increased 1.96 percent overnight.

The champagne bubbles, however, flattened quickly. Within 12 trading days, according to the researchers, the paper profits for the smallest stocks disappear. Gains for the overall stock sampling also quickly evaporate.

The study also concluded that "Mad Money" attracts a lot of vultures, who tune into the show to feast on fresh meat. Short- sellers bet against the Cramer addicts, who are backing up their 18- wheelers, because they suspect that these stocks will deflate quickly. And when they do, the short-sellers, who are most likely hedge fund managers, want to cash in.

Not surprisingly, Cramer isn't impressed by the doctoral students' enterprise. In an e-mail, Cramer gave the Northwestern paper a "D" and insisted that "their study is not only deeply flawed but worthless." What particularly unhinged Cramer was that the students didn't acknowledge that he warns his viewers to resist the temptation to immediately buy his picks. He urges his viewers to do their own homework and use limit orders to protect themselves when purchasing stocks. "How can they (researchers) ignore it?" he asks. "I believe I have said it more than 100 times at last count."

Perhaps not wanting to cross sabers with Cramer, the students declined to answer my questions. In an e-mail, however, Engelberg emphasized that the purpose of the research paper wasn't to evaluate Cramer's stock-picking acumen.

"We say nothing about whether he makes good or bad picks," he said. "The purpose of the paper is to examine the reaction of traders to his recommendations and use this reaction to say something about the Efficient Market Hypothesis."

Above the din of "Mad Money's" crying babies, roaring bulls, blaring trumpets and other canned sound effects, the students make a worthy point. Many academics, as well as seasoned investors, believe that the only sensible way to deal with Wall Street chatter -- no matter what its decibel level -- is to wear ear plugs, because none of it makes any difference.

Those who believe that the markets are efficient insist that all the information available about a stock is fully and immediately reflected in its price. Hence, researching stocks is beyond futile. And, I'd add, investing in individual stocks is far too risky for the potential rewards.

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