THE WALL STREET JOURNAL.

THE INTELLIGENT INVESTOR

There's Lots of Places Like Home

Good afternoon.

Home bias, the tendency for investors to stick to whatever is familiar, can distort portfolios several ways.

It can lead us to keep too much money in the country where we live, the company where we work and the industry it is in.

People invest more in companies headquartered near their homes.

Even professional fund managers put more money in the stocks of companies located nearby. They also favor companies based in the states where the managers grew up.

Venture-capital firms, too, invest more within their own state.

Financial advisers who spend their days telling clients to diversify keep far too much of their own retirement assets in the company where they work.

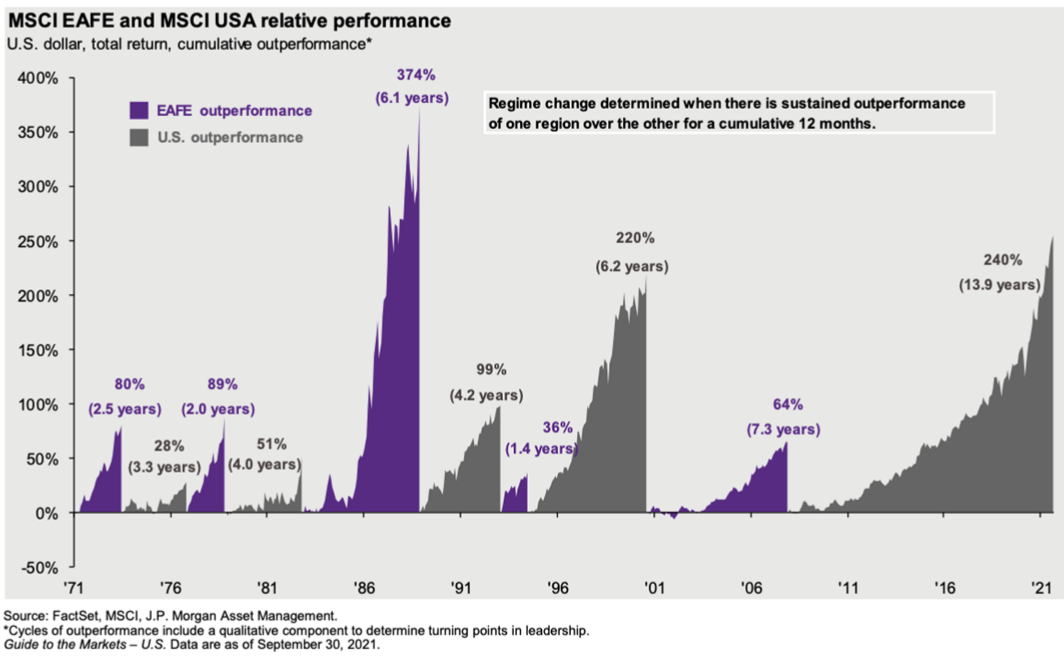
Right around the time the Japanese stock market peaked in late 1989, individual investors in Japan kept about 98% of their portfolios in domestic stocks.

U.S. investors are much more globally minded than they used to be, but it's been a long time since that has paid off.

Over the past 15 years, the S&P 500 has returned 10.4% compounded annually; the MSCI EAFE index of developed international markets has grown at 4.1%.

That's gone on so long, the U.S. has come to feel like the only place worth investing.

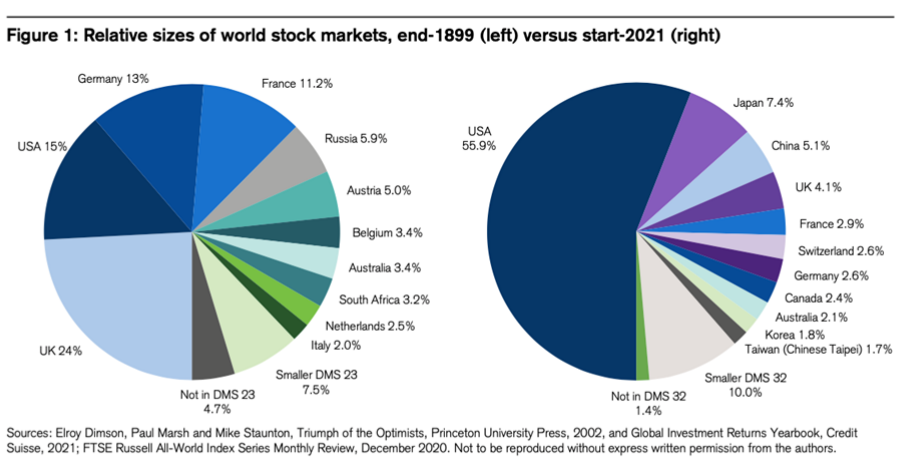
But other markets have outshone the U.S. in the past, as the latest installment of J.P. Morgan Asset Management's [Guide to the Markets] shows:



Non-U.S. stocks in purple; U.S. stocks in gray. Source: J.P. Morgan Asset Management.

Over the full sweep of the past half-century, the U.S. still outperforms, but by far less, about two percentage points annually.

Today, the U.S. dominates global markets as no other nation has in the modern era:



[Credit Suisse Global Investment Returns Yearbook 2021]

Will that last indefinitely? I suppose it could, but I doubt it.

I still think international stocks, despite their decades of underperformance, are a hedge against the risk that the U.S. won't always be the world's dominant market.

What do you think?

I'm telling you, kid, it's a big world out there.
Felix Vallotton, "The Red Room, Etretat" (1899), Art Institute of Chicago

The WSJ Wayback Machine

Speaking of home bias, I can't wait to listen to every episode of the new WSJ podcast series, [Bad Bets](), whose first season commemorates the 20th anniversary of the implosion of Enron Corp.

https://www.wsj.com/podcasts/bad-bets

It's hosted by John Emshwiller and Rebecca Smith, who were covering Enron in 2001.

Here's their story from 20 years ago this month:

Enron Jolt: Investments, Assets Generate Big Loss

Part of Charge Tied To 2 Partnerships Interests Wall Street

By JOHN EMSHWILLER
And REBECCA SMITH
Staff Reporters of THE WALL STREET JOURNAL

Enron Corp. yesterday took a $1.01 billion charge mostly connected with write-downs of soured investments, producing a $618 million third-quarter loss. The loss highlights the risks the onetime highflier has taken in transforming itself from a pipeline company into a behemoth that trades everything from electricity to weather futures.

In addition to the size of the charge, a particular slice raises anew vexing conflict-of-interest questions. The slice is connected with a pair of limited partnerships that until recently were run by Enron's chief financial officer. The company said the charge connected with the partnerships is $35 million and involves the "early termination ... of certain structured finance arrangements."

Two years ago, the chief financial officer, Andrew S. Fastow, entered into the unusual arrangement with his employer. With the approval of the board of Enron, Mr. Fastow set up and ran the partnerships that stood to make him millions or more, according to partnership documents. While the company says that this arrangement was proper, some corporate-governance watchdogs have questioned whether a chief financial officer, who is responsible for overseeing the financial interests of the company, should have been involved in such a partnership that was, among other things, looking to purchase assets from Enron.

The two partnerships, **LJM Cayman** LP and the much larger **LJM2 Co-Investment** LP, have engaged in billions of dollars of complex hedging transactions with Enron involving company assets and millions of shares of Enron stock. It isn't clear from Enron filings with the Securities and Exchange Commission what Enron received in return for providing these assets and shares. In a number of transactions, notes receivable were provided by partnership-related entities.

Mr. Fastow's role as chief financial officer made him privy to internal asset analyses at Enron. An offering memorandum for the LJM2 partnership said that this dual role "should result in a steady flow of opportunities ... to make investments at attractive prices." Mr. Fastow would find his interests "aligned" with investors because the "economics of the partnership would have significant impact on the general partner's wealth," according to this document.

In a written statement in response to questions, Enron, based in Houston, said "there never was any obligation for Enron to do any transaction with LJM. Enron and its Board established special review and approval processes with its senior management and external audit and legal counsel to ensure that each transaction with the LJM partnership was fair, in the best interest of Enron and its shareholders, and appropriately disclosed."

Mr. Fastow, through an Enron spokesman, declined to be interviewed.

In announcing the third-quarter loss, Enron said the partnership-related write-offs were part of a larger $544 million charge related to the diminished value of investments in a retail-power business, broadband telecommunications and technology. In addition, there was also a $287 million write-off resulting from its investment in Azurix Corp., a water company Enron spun off and then repurchased. In all, Enron posted a third-quarter loss of 84 cents a share, compared with a gain of 34 cents a share in the year-earlier period. Revenue rose 59% to $47.6 billion.

At 4 p.m. yesterday, Enron's stock was up 67 cents a share to $33.84 in composite trading on the New York Stock Exchange, but remains far below its 52-week high of $84.88. On Monday, the day before the earnings announcement, Enron stock

Please Turn to Page C17, Column 4

The Wall Street Journal, Oct. 17, 2001, p. C1.

To me, a few things about Enron remain remarkable two decades later.

First, corporate fraud can occur in broad daylight.

At its peak in 2000, Enron had $100 billion in revenue and a total stock-market value of $70 billion. It was one of the most widely owned companies in the U.S.

What's more, Enron's proxy statement, a public document anyone could have read at the time, didn't hide the conflicts of interest between the company and its chief financial officer, Andrew Fastow, that were at the heart of the fraud:

> During 2000, certain Enron subsidiaries and affiliates (defined for purposes of the following paragraphs, "Enron") entered into a number of transactions with LJM2 Co-Investment, L.P. ("LJM2"), a private investment company that primarily engages in acquiring or investing in energy and communications-related investments, primarily involving either assets Enron had decided to sell or risk management activities intended to limit Enron's exposure to price and value fluctuations with respect to various assets. Andrew S. Fastow, Executive Vice President and Chief Financial Officer of Enron, is the managing member of LJM2's general partner. The general partner of LJM2 is entitled to receive a percentage of the profits of LJM2 in excess of the general partner's portion of the total capital contributed to LJM2, depending upon the performance of the investments made by LJM2. In ten of these transactions LJM2 acquired various debt and equity securities, or other ownership interests, from Enron that were directly or indirectly engaged in the domestic and/or international energy or communications business, while in one transaction LJM2 acquired dark fiber from an Enron subsidiary. The aggregate consideration agreed to be paid to Enron pursuant to these eleven transactions was approximately $213 million. Also during 2000, LJM2 sold to Enron certain merchant investment interests for a total consideration of approximately $76 million.

from Enron's 2001 proxy statement, SEC.gov

As the head of LJM2, Mr. Fastow would naturally seek to buy assets for the partnership at the lowest possible price. As Enron's CFO, he had an obligation to sell assets at the highest possible price. LJM2 was both buying assets from and selling assets to Enron.

Dazzled by Enron's past growth, analysts and fund managers never seem to have asked the questions that seem howlingly obvious in hindsight:

- *How could Mr. Fastow possibly negotiate a fair price for Enron when he was sitting on both sides of the table at once?*
- *Why did Enron permit him to take a personal stake in LJM2's potential profits, which could only come at Enron's expense?*

The sunlight of disclosure does no good if no one ever looks at what the disclosures say. And the size and stature of a company, no matter how great, are no guarantee that it will do the right thing.

Second, even many top insiders had no idea how severe Enron's misconduct was. Ten years ago I interviewed a former Enron executive who was among the company's top global managers. He had no inkling it was in trouble until:

> **EE:** I was in Moscow at the time, working out of our office there. My driver picks me up and drives me to our office building. I get out, and my keys do not work in the front door. I call my executive assistant at home, and there's no answer. I had my driver call the Russian federal police, the equivalent of the secret service, and he was told the locks had been changed by the government because they had gotten word overnight that Enron had just gone up in smoke.
>
> It was that sudden. We were totally in the dark. Among the employees and executives I worked with, there was nothing on anyone's horizon that anything at the company was untoward or that anything untoward was even contemplated. None of us had any concept or knowledge that Enron was in trouble.

The Wall Street Journal, **Dec. 5, 2011.**

Third, working at a company can give you a dangerous illusion of inside knowledge.

The history of corporate malfeasance is consistent over the centuries: A few people at the top do bad things and hide them from everyone but a tiny group of confidants. You can work at a company -- even be a senior executive -- and remain as deeply in the dark as any outsider.

As the same executive told me:

> *TR: What happened to your portfolio when Enron collapsed?*
>
> **EE:** I lost roughly 90% of my net worth in a week. I never recovered. My marriage of 22 years blew up, and my entire network was nuked. I realized almost immediately that [complete] financial recovery wasn't possible.... Even today, I worry that I might not be able to find a financial road to provide adequately for my son [who is in second grade].

The Wall Street Journal, **Dec. 5, 2011.**

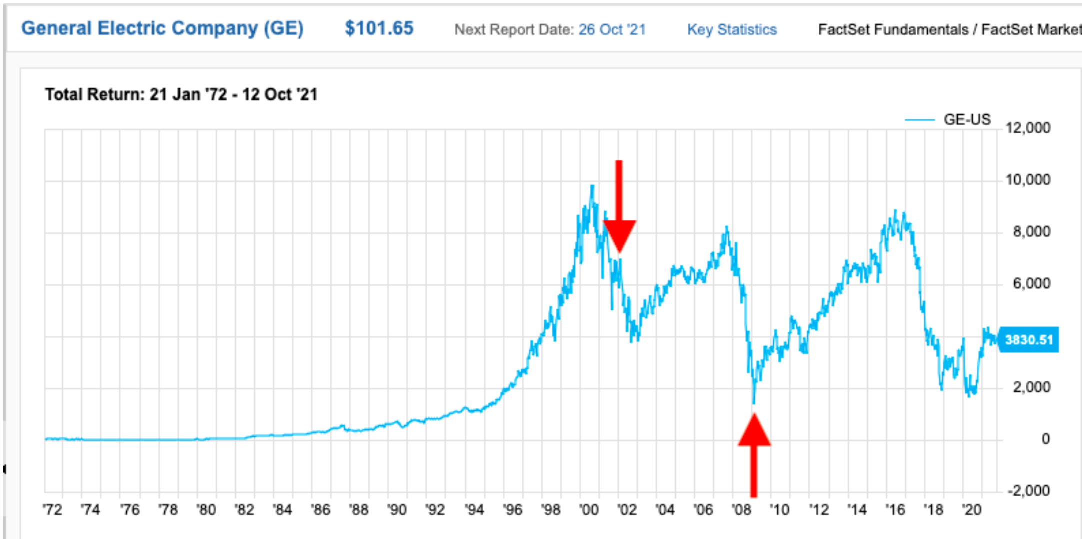
Not long after Enron collapsed, I was speaking to a group on individual investors about 401(k) investing and told them that they should never put too much in their own company's stock, because it could turn out to be the next Enron. Instead, they should diversify.

A man in the back of the room stood up and started screaming at me.

"You're telling us to diversify?" he hollered. "I want to *avoid* the next Enron! If we diversify, that guarantees we'll *own* the next Enron!"

After I calmed him down a little, he explained that he worked for the greatest company in America, he knew everything about it, he had nearly all his retirement money in it and he would never diversify -- because he never wanted an imploding company in his portfolio.

Where, you ask, did he work?



Source: FactSet.

That's right, General Electric!

The left arrow is right around the time of that investor's outburst. The right arrow shows GE's stock hitting bottom seven years later, more than 80% below where it was when he proclaimed that he knew everything about it and that it couldn't possibly go down.

Two decades later, it's still almost two-thirds below where it was the day he got so angry.

As I told David Brancaccio on [a recent episode of NPR's *Marketplace*](),

I don't know whatever happened to that fellow. I hope at some point he diversified before it was too late. But what a terrible way to learn an important lesson.

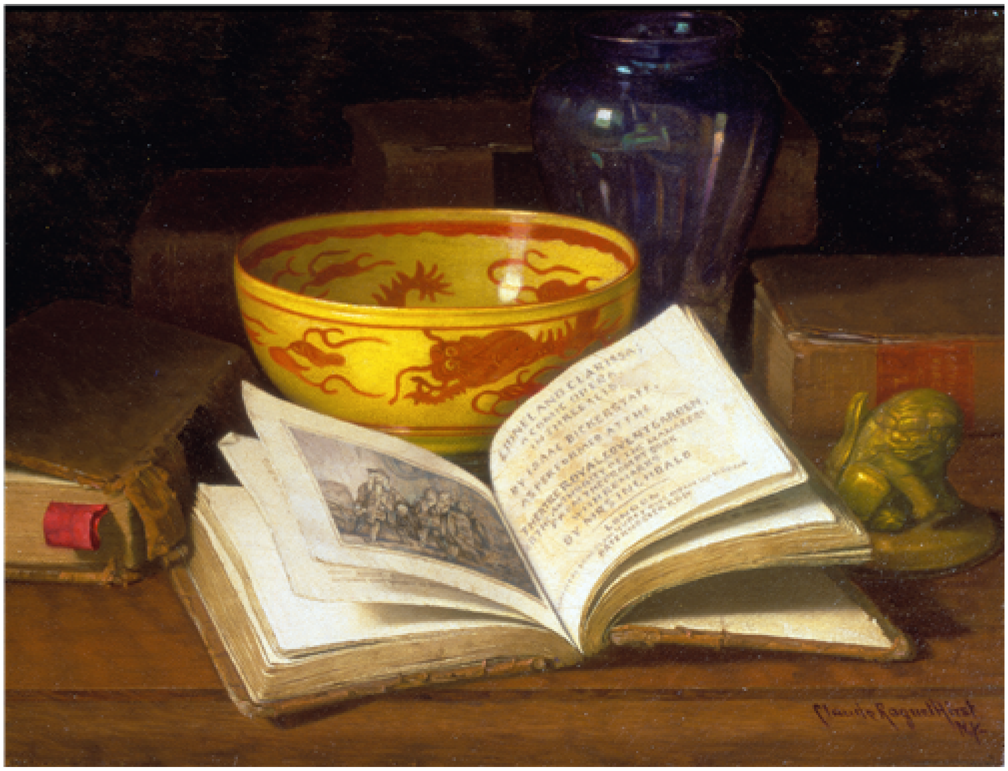
Think About It

The funniest, shortest and wisest thing I heard this week was [from the comedian Kyle Kinane]():

"I don't understand why the people that play the lottery aren't more afraid of lightning."

(h/t Dan Bergstresser)

Some Insights You Shouldn't Miss



Claude Raguet Hirst, "Still Life with Bowl" (1922), Museum of Art and Archaeology, University of Missouri

Here are some of the best things I found over the past week outside *The Wall Street Journal:*

- Your portfolio doesn't have to be perfect to be good, says blogger Adam Grossman
- 2021 just broke the record for most ETF launches, says ETF.com
- When your money grows, you can shrink, warns blogger Ben Carlson
- Day traders are seeking help from addiction counselors, says the Financial Times
- Index funds could come to venture capital, says blogger Tom Tunguz
- Why is there suddenly a shortage of almost everything? asks the Atlantic
- How the World Bank manipulated data (CGD blog)

Here are some of the best things I found recently in *The Wall Street Journal:*

- SEC head Gary Gensler tells Paul Kiernan and Dave Michaels he's targeting Wall Street's fees
- How high are tax rates on the rich? Depends whom you ask, say Rich Rubin and Rachel Ensign
- Young people are banding together to buy houses, Alex Janin shows
- China's crackdown on companies has just begun, reports Lingling Wei
- China Evergrande has been unraveling for years, explain Brian Spegele, Julie Steinberg and Elaine Yu
- The real-life Mafia is as messy as *The Sopranos*, Jim Fanelli finds
- Our reviewer likes a new book on Harry Guggenheim, who funded the birth of aviation

Question of the Week

Do you think it's a good idea to limit how much you invest in your own company, industry or home region?

To share your thoughts, just hit reply to this email. Answers may be lightly edited for space or clarity. Please include your name and city, thanks!

Last Week's Question

In our Sept. 28 newsletter, after my Sept. 24 column, "What the 'Smart Money' Knows About China's Evergrande Crisis," I asked:

Do you think China will outperform other stock markets? Why or why not?

Super bullish: policy easing, a litany of bad news now more or less fully absorbed, underweight foreign investors and massively discounted valuations in tech, energy and financials.
—Jonathan F.K. Neill, *London*

Will not. Common prosperity suggests that minority shareholders will have part of their future returns redirected towards "the cause" whether

they like it or not. Cashflows need to be adjusted accordingly, and valuations need to de-rate to reflect this new reality.
—***Kenneth Yap,*** *Singapore*

Fool me once, shame on you, fool me twice, shame on me :)
—Amir Zaki, *Montreal*

As the late Nobel Laureate Merton Miller correctly pointed out: "Diversification is your buddy." If China outperforms in the future then [a globally diversified investor] will have a piece of that performance. And, if not, then you'll not be harmed in any significant way.
—Frederick C.Taylor, *Montreal*

Money Mailbag

Mary Cassatt, "The Letter" (ca. 1890), Art Institute of Chicago

Have a question you'd like me to answer?

Want to weigh in on what you just read? Got a tip on something that I or my colleagues should investigate? Itching to tell me I'm wrong about something?

Just reply to this email and I'll see your note. Don't forget to include your name and city.

Be well and invest well,

Jason

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Julie de Geluk, "October" (1917), Rijksmuseum

Last Word

Build thee more stately mansions, O my soul,
As the swift seasons roll!

—Oliver Wendell Holmes, Sr.