Review of Book Entitled *Protecting Against Inflation—and Maximizing Yield*: Comment

by
John M. Bragg

I wish to thank Mr. Robert Puelz (1988) for his numerous complimentary remarks in his review of my book entitled *Protecting Against Inflation—and Maximizing Yield*. The book was intended to sensitize financial service professionals to the horrors of decreased purchasing power; to provide useful information about insurance product performance; and to provide clear information about Life of Georgia's experience with the Cost of Living policy, in the hope that other insurers will answer the challenge of inflation. I am glad that Puelz found the ideas about future financial products to be thought-provoking. However, there are a number of points which I would like to clarify.

Puelz states: "Although written with an investment fund manager in mind, this book can just as easily be understood by a novice." The book was, in fact, written for "investment novices" among whom are: persons supervising or reviewing the work of investment fund managers, but who are not professional managers themselves; persons designing financial services products; owners of some financial services products, who are expected to make their own investment decisions in spite of a lack of professional expertise in the field (this would include owners of universal-variable plans and numerous other products); and life insurance agents and financial services professionals who find themselves in the position of discussing investment strategy questions with clients. Investment results have become too important to leave solely to the fund managers.

I take exception to Puelz's remark: "In some ways the credibility of the book is tainted by the inclusion of the chapter on investment strategy." That chapter reaches the optimistic conclusion that investment performance can overcome inflation. This is a fundamental point, making the various financial services products viable. Because of this fundamental point, and because this is a book about inflation, it was necessary to explore how investment performance, which might overcome inflation, could best be achieved. The chapter on investments certainly did need to be included.

Mr. Puelz discusses the Theory of the Economic Series, which is at the core of my investment strategy. I will summarize the strategy as follows: —The business cycle can be broken down into four periods—one optimistic, one pessimistic, and two changing. Investment yields and other economic results vary remarkably from one period to another; this is especially true relative to three principle forms of investment: three month bills, long term bonds, and common stocks. To achieve the most satisfactory protection against inflation, this variation must be understood and used. Various trading strategies are considered; the one recommended in the book is the Prudent Mixture Strategy. Any trading strategy depends on determination of economic period. The book suggests the theory of underlying mood as one means of determining economic period; this is a controversial suggestion which might just turn out to be correct.

Puelz apparently has difficulties with the efficiency implications of the theory. The "Efficient-Market Hypothesis" is often described and research by financial writers, but not all agree with it. Farrell (1983), for example, after a thorough discussion of the hypothesis, states: "There is opportunity for managers to develop superior insights with the potential for above-average performance." I myself disagree with the efficient market hypothesis because of long observation of the fact that fund managers, when faced with the same set of circumstances, do not all take the same course of action; their courses of action can differ very widely.

Puelz also has difficulties with the underlying mood theory. He states: "No doubt psychiatrists knowledgeable in projectionism would have certain arguments against the accuracy of a single investor's measurement of the state of social psychology." The underlying mood theory was developed in consultation with a distinguished professor who is an authority on psychiatric phenomena, and who believes very strongly in the theory. I can say also that economic period need not be determined by a single individual; it can be determined by consensus judgement of experts in various applicable fields. Puelz also states: "Reasonable people must ask why this theory would fare better than another theory", but does not mention any such other theory for determining economic period. (Waiting until the economic statistics have appeared is probably too late!) I believe there is a dearth of good theories for this purpose. I would be very happy to see such theories developed and used. As I stated in the book: "Any effort to determine economic period is worthwhile because the best investment strategies differ so remarkably from one period to the next."

It is my hope that the book will stimulate new thought on an important subject: protection against inflation. Puelz's review is a fine contribution along these lines.

References

1. Puelz, Robert, 1988, Review of Protecting Against Inflation—and Maximizing Yield, *The Journal of Risk and Insurance*, 55: 773-74.
2. Farrell, James L., 1983, *Guide to Portfolio Management* (New York: McGraw-Hill) 21-23.