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By BRETT ARENDS

Ten Busted Investing Myths

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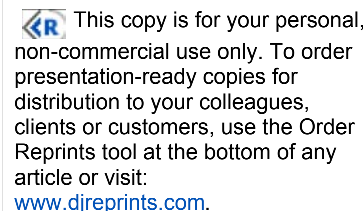
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The market slump isn't just shredding millions of college funds and retirement accounts.

It's also shredding the financial playbook that many American families had come to rely on to protect and grow their savings.

Think of all the rules and beliefs that worked reliably for decades, and which have been trashed in the last year.

Rule #1: You can safely trust the stock market to outperform over a decade.

Reality: Anyone who invested in Wall Street in the summer of 1998 and held on has earned just 9%. That's the total return on the Standard & Poor's 500 index, and includes reinvested dividends. And that's before inflation. Bonds, and savings accounts, did far better. If you held your cash in an account earning an average of just 3%, for example, today you'd be up 34%.

Rule #2: Don't try to "time" the market.

Reality: OK, you may not be able to "time" the market perfectly, but you can often value it – especially when it goes to extremes. Last year it should have been obvious to everyone that European stock markets had become overheated – while those in Asia, especially China, were in a huge bubble. Yet too many investors kept on buying (in the name of diversification, of course; see Rule #5 below).

Rule #3: Wall Street bankers know what they are doing.

Reality: Almost none of them saw this coming. The people running Bear Stearns didn't even know how much their own bank was worth at the end, let alone their loan book. The head of Citigroup was still betting on subprime loans last July, months after the industry had hit the iceberg. How many Harvard MBAs and Chartered Financial Analysts does it take to lose a trillion dollars on subprime mortgages? We'll let you know when this is all over.

Rule #4: The Fed, and the world's other central bankers, are steering the ship.

Reality: Five words: Alan Greenspan…and Ben Bernanke.

Rule #5: International equities give you a lot of diversification.

Reality: In a global market, no one is spared. The U.S. subprime crisis has hit many European markets much worse than Wall Street (among the early casualties was Northern Rock plc, a mortgage bank in England). And those booming Asian markets? They've done worse than the U.S. China's economy is still

growing quickly, but the stock market is still down 50% from its peak.

Rule #6: Value and equity income funds will protect you in a downturn.

Reality: Many of these funds have done very badly. That's because a lot of "value" stocks started out overpriced. And many of these funds were loaded up to the gunwales with high-yielding banking stocks.

Rule #7: Financial markets are rational.

Reality: Throughout this crisis they've been all over the place – once again. Among the many examples: Banks were refusing to lend to perfectly sound municipalities last winter, and buying inflation-protected government bonds instead - at a zero percent real yield.

Rule #8: The U.S. housing market never goes down.

Reality: The U.S. housing market didn't go down between 1945 and 2005. But so what? Investment strategies based entirely on history are useless without a time machine.

Rule #9: Mortgage debt doesn't matter because the value of your house will keep going up.

Reality: See above.

Rule #10: Real estate and mortgage brokers can successfully advise you about economic trends and the direction of interest rates.

Reality: This is how so many people ended up in adjustable rate mortgages. After all, how bad could the resets be?

Many Americans are going to need to learn some new rules if they want to reach their financial goals. Those with long memories suspect those "new" rules will look a lot like the "old" rules that were around before the big bull market got going in the 1980s.

Write to Brett Arends at brett.arends@wsj.com[1]

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(1) mailto:brett.arends@wsj.com

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