

CHAPTER 1

The Top 10 Lessons Hollywood Teaches Us about Investing

As you're now likely seated in the comfort of your own private theater awaiting the feature presentation, I bring to you "The Top 10 Lessons Hollywood Teaches Us about Investing" with an extra bonus thrown in at the end.

So, raise the curtain and start the projector, because here we go.

Lesson 1: Diversification Is the Key to Success

Hollywood. The typical Hollywood studio releases somewhere around 20 films per year. Does Paramount release 20 horror films each year? Not quite; the studios are much smarter than that. Most studios cover all genres—romantic comedy, science fiction, drama, action, teenage comedy, and so on. Why? They know it's impossible to predict which genre will be hot at any given time. Some will win and some will lose, but only one thing remains certain: Reducing risk through diversification always provides the best recipe for success.

Investors. Forget the line Oliver Stone wrote for Michael Douglas in *Wall Street*. Greed is *not* good. Greed can kill you. If you need proof, ask anyone who was too heavily invested in technology during the late 1990s.

Lesson Learned. Whether it's the lineup for this year's releases or a decision on where to invest, diversification among the standard asset classes is the first rule of consistent and successful investing.

Lesson 2: It Doesn't Have to Be Complicated for It to Be Effective

Hollywood. Years ago, I pitched many film projects to studios and learned the hard way that if you can't tell your story in a few minutes or less, you'll never make it through the pitch, let alone get a movie made. Every classic movie can be summarized in a single, simple sentence. If you make it any more complicated than that, forget it; you'll never get the film made. Learn from *E.T. the Extra-Terrestrial*: "It's a story about a bunch of kids who help a stranded alien get back home." One sentence, \$756 million . . . just the way Hollywood likes it.

Investors. Here's a simple sentence: The S&P 500 index typically outperforms most managed mutual funds. Period. Statistically, those who invest in the S&P 500 and nowhere else have a better chance of *consistently* making more money than those who invest in a phone book of individual stocks, which are typically complicated and quite difficult to keep track of. For those who think trading individual stocks by themselves or through professionals earns more dollars, I offer a humbling fact: There are over ten thousand mutual funds in the country. Each fund has one or more professional money managers who trade stocks all day long, trying to pick the winners. Of those managers, guess how many have successfully outperformed the static, untraded, mindless S&P 500 more than 10 years in a row? Answer: just one—the legendary Bill Miller from fund company Legg Mason.

Lesson Learned. While it makes little sense to put all of your money in one place such as the S&P 500, the concept prevails: You don't need a complicated portfolio for it to be effective. Some of the most successful and rewarding investment engines I have ever witnessed, built or tuned up are extremely simple to understand, easy to monitor, and more rewarding than most people can possibly imagine.

Lesson 3: It's the Details That Count

Hollywood. James Woods once told me that while shooting the epic *Once Upon a Time in America*, legendary director Sergio Leone shot a few dozen takes of a dinner scene just to get a spoon in the right place. Screenwriter Peter Shaffer wrote a few dozen full-length drafts of his masterpiece *Amadeus*, then another dozen or so to refine it. Writer/director Cameron Crowe once said he spent well over a year doing absolutely nothing but writing one of the truly great screenplays in modern years—*Jerry Maguire*.

Investors. A financial advisor touts an appealing investment. It sounds decent, so without checking the facts, you agree to move money in, only to realize a month later that it's an illiquid limited partnership managed out of Estonia that can't be sold for another 18 years.

Lesson Learned. The fine print of any investment is more important than the window dressing itself. Ask questions and be sure to read the details; and if the spoon isn't in the right place, take your time to get it right.

Lesson 4: Costs Are Critical

Hollywood. An actor's most recent movie made more than the gross domestic product of Norway. He pitches his pet project and the studio green-lights it. While everyone works hard for it to be a hit, the budget skyrockets out of control and the movie is \$250 million in the hole before anyone ever lays eyes on it.

Investors. A star money manager with a fantastic track record takes over the reins at a popular mutual fund. The offices are filled with expensive furniture, great food, a couple of espresso machines, fine art, and a magnificent pool table. Who is paying for all this stuff? You are—whether you realize it or not, the fund is taking it right out of your pocket. It doesn't matter whether the money manager makes or loses you money; it's you who's funding salaries and overhead, and that's not very efficient.

Lesson Learned. Fees kill returns. The less they take, the more you make—a simple, yet extremely important rule for investment success. Take, for example, an investor I recently met who couldn't understand why he wasn't making much money. A review of his holdings revealed he was paying a whopping 6 percent in annual fees and taxes on an investment portfolio worth just over \$600,000. Over the seven years he's been in it, that's over \$250,000 in fees and taxes alone. Ouch.

Lesson 5: Planning Is Key

Hollywood. Once green-lit into production, a screenplay is broken down into extremely precise, line-item moviemaking elements: costs, schedules, camera shots, makeup, hair, costumes, props, scenery, stunts, transportation, and a thousand other things. On the set, minutes can cost tens of thousands of dollars, if not more. Regardless of how good or bad the script is, a well-planned production is an incredible,

well-oiled machine of intelligent efficiency, with thousands of people who often know exactly what they are doing every moment of the day all building toward one definitive, concrete goal—the date of release.

Investors. A few years from retirement, you suddenly wake up wondering how you are going to generate enough income off your savings to support the lifestyle you always wanted. After a few last minute calculations, your advisor realizes you're not going to make it. In a last ditch effort to save you, the advisor moves your money into the risky stuff and starts rolling the dice. Throwing for a high return, unlucky 7 comes up and you unfortunately find yourself crapped out. Dejected, you realize that your working life is going to drag on a few years longer than you anticipated.

Lesson Learned. Most movies take many years to plan. The smart guys realize that success rarely has shortcuts and can't be rushed; it has to be nurtured. If your investments are to end up with an Oscar, hard-core planning provides the greatest chance for success. Remember, this is *your life* we're talking about, not some trashy two-hour drive-in movie.

Lesson 6: Cut the Losers, Ride the Winners

Hollywood. By 7 P.M. on opening night, movie studios can predict with incredible accuracy the revenue a film will likely generate. Even more startling is the DVD market. Due to sales tracking systems at Wal-Mart, it's possible for the studio to accurately predict how much revenue it will earn by 3 P.M. the day of release. What will the studio do if the film is looking like a loser? Do executives pour endless money into advertising, hoping everyone will start loving it as much as they once did? No way. Advertising and marketing expenses are immediately cut, and in some cases, they are completely eliminated.

Investors. You buy a stock because you just love the company. For a while, it climbs. But then the downward spiral begins and it dips, and dips, and dips even more. You sit back and watch the stock do nothing but drop some more. You just love that company, though. Your broker reinforces your emotions and keeps telling you it will come back, but it rarely does.

Lesson Learned. As much as the studio execs might love a film, they rarely let emotions get the best of them. If something isn't working, they just cut their losses and move on. When it comes to your investments, you need to do the same. A stock doesn't know

who you are; it couldn't care less about you, and it certainly has no emotional bond with you. Only you do. And as soon as you let your own emotions get in the way, bad things typically happen.

Lesson 7: Experts Focus on Reducing Risk; Novices Focus on Return

Hollywood. Many films have nearly bankrupted their creators. *Hudson Hawk*, *The Last Action Hero*, and *Cutthroat Island* are just a few examples that come to mind. As a result, partnerships on expensive features are now the norm. Take *Titanic*, for example. James Cameron wakes up one day with an idea to make a film about two people that fall in love on a sinking ship. One short sentence, over \$200 million to produce. So what does Fox do? It partners with Paramount to reduce the risk. It's easy to look back and say Fox should have taken *all* the risk so it could have received *all* the return, but who would have thought *Titanic* would go on to become the most successful film ever made?

Investors. A few years back, the *New York Times* ran a feature article reporting where retired Federal Reserve chairman Alan Greenspan invests his money. He stated that he invests 95 percent of his money in U.S. Treasuries. In another interview, Suze Orman said most of her money is tucked away in AAA-rated insured government municipal bonds. Both are focused on only one thing: keeping their money, not losing it.

Lesson Learned. It's simple: If you don't need the *potential* return, why take the risk? Don't ever forget that. It could be one of the most important lessons you'll ever learn.

Lesson 8: Don't Reinvent the Wheel

Hollywood. In 1949, writer and scholar Joseph Campbell wrote a legendary thesis entitled *The Hero with a Thousand Faces* (Princeton University Press). His exhaustive study concluded that regardless of plot, all great stories throughout history share a very distinct and common structural foundation: The hero is introduced in his ordinary world; he receives a call to action; he refuses the call; a mentor convinces him to cross over the first threshold into the unknown; and so forth. Whether the story is out of the Bible, *Star Wars*, *Beverly Hills Cop*, or *The Lion King*, Campbell's handful of common elements can be found in virtually every timeless story.

Investors. Warren Buffett, along with many others, including myself, considers Benjamin Graham's timeless, early 20th century book *The Intelligent Investor* to be the bible of investing. In it, Graham teaches us to invest not to maximize profit but rather to minimize loss; to use discipline, research, and analytics to make unpopular but sound investments in undervalued stocks. These principles have stood the test of time and created significant wealth for Buffett and many others who avoid the frenzy and stick to Graham's most basic, timeless fundamentals.

Lesson Learned. The foundations of movie magic and intelligent investing were developed a very long time ago. Whether it's your next screenplay or stock pick, following the tried-and-true principles while avoiding the get-rich-quick schemes hands down gives you the best chance for consistent and efficient investment success.

Lesson 9: Complacency Is the Mother of All Disasters

Hollywood. The studio and production team can easily take a year just to plan the shoot. However, when it comes to filming on location, anything can happen. My personal experience on a film I once produced included: stolen cameras, violent weather, an actor nearly overdosing on diet pills, an angry mob wielding machetes, a generator falling off a cliff, food poisoning, stray horses, and a misplaced wardrobe truck a light-year from civilization. Some of the sharpest people I've ever worked with have saved entire productions by anticipating, thinking ahead, taking action, and making rapid-fire decisions.

Investors. Check out Morningstar's fund rankings at www.morningstar.com. Take a look at the list of last year's top-performing funds; then where they are today. With some exceptions, yesterday's top performers are often this year's *Reservoir Dogs*. Like a good film crew, the sharp investor understands that monitoring, rebalancing, and updating a portfolio is essential for continued and rewarding success.

Lesson Learned. Stray horses and misplaced wardrobe trucks won't kill you, but complacency will. Whether it's producing a movie or investing to make money, anticipation, quick decisions, and action are the golden keys to anyone's success.

Lesson 10: Defy Conventional Wisdom and Take Smart Risks

Hollywood. Many of the most critically or commercially successful films ever made have been the ones that crack the mold of conformity,

think outside the box, and go against the grain of conventional wisdom. *Pulp Fiction* turned the standard three-act narrative structure inside out; *Memento* ingeniously told the story backwards; and *Unforgiven* was one of the few films to successfully pull off making the villain the hero. Time and again, Hollywood has taught us that to stand out from the rest, you sometimes have to defy conventional wisdom, follow your gut, and have the courage to stop thinking like everyone else.

Investors. Emotions typically get the best of us. When the market is crashing, many people sell their stocks, but guess what? For every stock that gets sold, there has to be someone on the other side to buy it. Who are those beings buying your stock when the market is crashing? Aliens from another planet? Not quite. They are investors clearly going against the grain of popular wisdom, defying the masses, and, for better or worse, thinking outside the box. Likewise, there are many alternative investments that fly high above mainstream thought and could be a tremendous addition to a diversified portfolio; yet many people shy away from them simply because they are not traditional; the guy at the pool never heard of the investment, the accountant laughed at it, or a bunch of people over at the club said bad things about it.

Lesson Learned. If you enjoyed unconventional films such as *Unforgiven*, *Pulp Fiction*, and *Memento*, then you have a distinct appreciation for a willingness to take educated and intelligent risks. When it comes to investing, some of the very best opportunities out there defy mainstream thinking. Often, riches are made when thinking outside the box and educating yourself on ideas that are not otherwise in the mass mind-set of conformity. Having guts is not about taking unnecessary risk; it's about educating yourself and occasionally investing in things that sometimes your neighbor doesn't care about.

And One More for the Road: If There's a Will, There's a Way

Hollywood. While making *Apocalypse Now*, Francis Ford Coppola overcame a civil war, Martin Sheen's heart attack, personal bankruptcy, unimaginable shooting conditions, and a potentially distracting thing called death. He defied mass adversity and somehow managed to get his classic film done. Then there's Spike Lee, who was literally dirt broke when he made his breakout film, *She's Gotta Have It*. Lee's book on the making of that film is a lifelong lesson in

intense perseverance, fearless courage, and laser focus. With only a few pennies in his pocket, Lee's intrepid tenacity amazingly found a way to get actors, a crew, film, cameras, locations, costumes, sets, music, editing, and a truly fantastic finished product. End result: a stellar career filled with an extremely impressive body of work.

Investors. Some of the most successful investors I've ever met started out with nothing. I'm not talking about Trump the billionaire; I'm talking about some truly incredible people such as Henry the electrician, Kyle the cop, Debbie the single mom, Lou the barber, Stan the piano teacher, and countless others. Although they basically started with nothing, year in and year out they somehow found a way to stash a little money away, taking one tiny baby step at a time by investing in smart, tax-efficient, and low-cost investments. End result: a fantastic retirement overflowing with an impressive standard of living most people would be extremely satisfied with.

Lesson Learned. Like most great film directors, Spike Lee envisioned his completed film long before it was finished, and nothing stopped him from getting it done. Likewise, envision your movie the way you want it to play out. Recognize there are no shortcuts. With the lessons in this chapter and the knowledge you'll get from this book, do whatever it takes to make sure your road toward or through retirement leads to a happy ending.

Fade lights . . .

With the previews over, it's now time to sit back and enjoy the feature presentation of this book. In the next handful of chapters, together we'll explore the above concepts in greater detail so that you, too, can end up with a few Oscars of your very own.

So, let's get going here. There's no time to waste and lots of money to make.

Close doors!

Lock set!

Roll sound!

Lights! Camera! Action!

. . . And let the show begin.