Reliability of Mad Money Stock Recommendations in Comparison with the S&P 500 Index

Matthew Dulansky - Humanities

Abstract

This paper assesses the credibility of the financial media show Mad Money based on the performance and distribution of the stocks recommended during the "Featured" segment of the show. Over 300,000 viewers watch the show every week night because of the possible monetary gains that can come from investing in the stocks recommended. In order to analyze the performance of all of the stocks on the show, a computer program was created to compile and categorize the data as needed. The stocks were analyzed for two years after the initial recommendation date on the show and each stock was compared with the S&P 500 index to further analyze the effectiveness of Jim Cramer when recommending stocks. This was all done in order to discover whether or not the stocks recommended on the show performed well enough to justify the large audience of the show. Ultimately, the findings support the hypothesis that the stocks recommended on the show do not outperform the S&P 500 in a statistically significant way, and investing in the portfolio is much riskier than investing in an exchange traded fund that mirrors the composition of the index. Therefore, the viewership of the show is not justified, and taking action on statements and recommendations made on the show is advised against.

Introduction

A plethora of information is available for anyone looking to invest their earnings into a public company with the interest of making money. Every tradable security has financial statements, along with thousands of opinions on whether or not it should be bought or sold. Individual investors have the strenuous job of rooting through this information and determining what to do with their money. The financial media has grown significantly in the previous 20 years because of the growth of the internet. Mad Money the is one of the most popular sources of information for investing, bringing in an average of 380,000 viewers a night. The show first aired on March 14, 2005, and it has aired nearly every weeknight at 6pm ET since then. It is hosted by ex-hedge fund manager Jim Cramer, who recommends stocks in various attention seeking tactics like yelling the statistics of a particular company, or using a soundboard to enunciate the importance of something he just said. There are eight separate segments throughout the show that all have their own twist, most notably is the "Lightning Round" where Cramer takes calls from his viewers, and gives them advice on whether or not to buy a certain stock. This section of the show has no actual previous research done, and it seems questionable as to what he is basing his advice off of. Another prominent part of the show is the "Featured" segment where Cramer gives a detailed report of a single stock that he recommends, this section has the most research put into it. Additionally, the "Featured" segment reflects the investing tendencies of his audience the closest because the strongest buy recommendations from Cramer have a much larger return over the five days after the initial recommendation date (Hinchey, 2007). As classified by thestreet.com, which tracks Cramer's recommendations, the stocks recommended during the "Featured" segment are all strong buy recommendations, therefore they are more likely to reflect how the viewers of the show will invest.

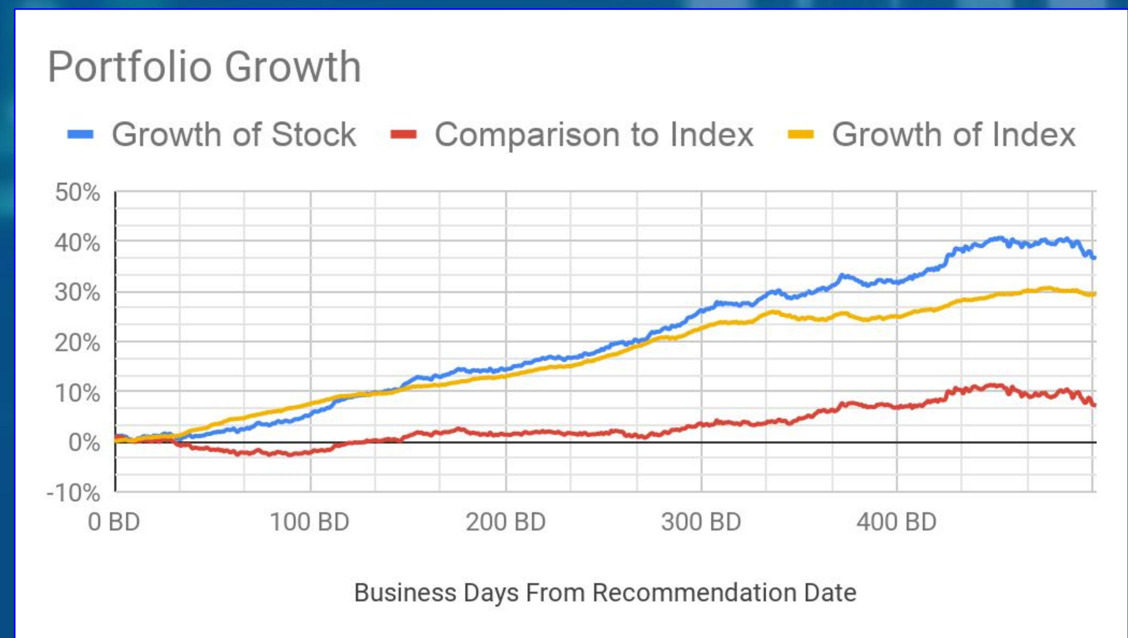
A portfolio made up of the stocks recommended on Mad Money would seem like a very arbitrary style of investment for a typical person, yet the show still gets hundreds of thousands of viewers a night. It is aired after work hours for most Americans and the enticing nature of the show draws many in to watch it. Overall the show's exciting and enthusiastic aurora are able to attract many young viewers to watch the show and potentially invest in the stocks that are recommended by Cramer, which is why it is the most watched show among 18-54 year olds on CNBC Phelps (2001).

Methods and Materials

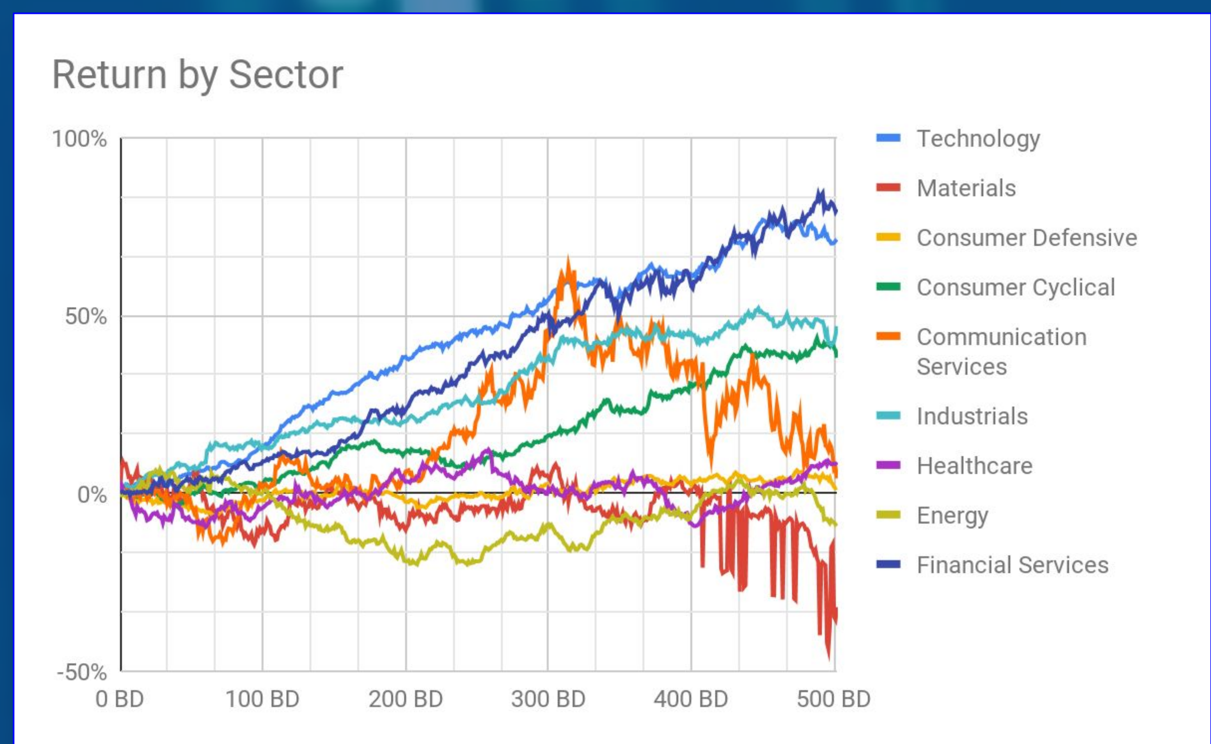
As mentioned earlier, the stocks recommended during the "Featured" segment are the only stocks assessed because they more accurately reflect the investing habits of the viewers on the show (Bolster & Trahan, 2009, p.2). The initial list of stocks recommended during the "Featured" segment of the show comes from thestreet.com, which lists the date a stock was recommended, the segment of the show that the stock was recommended during, and the symbol of the stock. While thestreet.com is owned by Cramer, the recommendation data is impartial because it is solely based off of the information that Cramer says in the show, and does not go into any further analysis. The oldest stock recommendations provided from this website came from the third quarter of 2016, but since the amount of stocks recommended during this quarter was not very large the stocks recommended during the fourth quarter were also used to fill the portfolio assessed in this paper. Occasionally, Cramer will recommend the same stock more than once, and when this happens the repeated stocks are treated as if another share of that stock was purchased at a later date. By doing this, it assures that the portfolio will show the true performance of Cramer's recommendations taking into consideration how he continues to recommend a certain stock.

Results

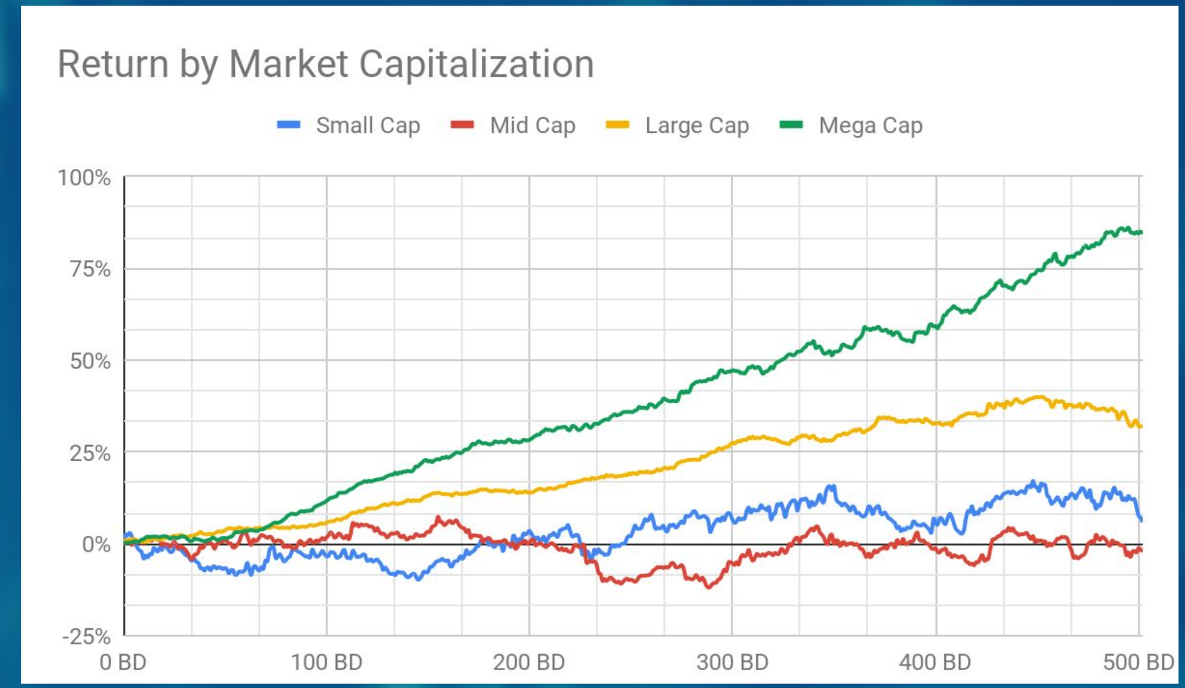
The main data outputted by the Python script comes in the form of the following graph:



To further show the credibility of Cramer the computer program categorized the percent returns of the stocks in the portfolio by market capitalization and sector. The distribution by sector is as follows:



The dispersion of the stocks by market capitalization are as follows:



Hypotheses

Null (H_0): Mad Money performs statistically significantly better than the S&P 500 (^GSPC) index.

Alternate (H_a): The difference in growth between the portfolio and the index is not significant, the portfolio is more erratic than the index, and it is a representative sample of the market.

Discussion

The reliance on only one category of stocks for the well-being of the entire portfolio increases the risk associated with the investment for the viewers watching the show because of how much capital is necessary to invest in the portfolio. Since the alternate hypothesis has already been proven to show that the logic behind listening to Cramer is false, the dispersion of the returns further supports the risk involved when listening to the recommendations. For these reasons it would be more intelligent to avoid taking action on what Cramer says because the size of the portfolio is large, the stocks themselves provide varied returns, and the portfolio is statistically no different than the index.

Conclusion

The performance of the portfolio compiled of stocks recommended on Mad Money when compared with the S&P 500 index is not indicative of positive endorsement related to taking action on the stocks recommended by Cramer. The 380,000 potential investors that watch the show should be wary of any investment advice from Mad Money because of the large variance of the daily percent return from the portfolio. On a daily basis the portfolio is ten times as volatile as the index which provides additional support towards the argument that the similarity of the portfolio to the index, the increased risk related to investments in the portfolio, and the grand amount of stocks in the portfolio explain why it is not a wise decision to invest in the stocks recommended on Mad Money. Investors would be better off putting their money in an exchange traded fund that mirrors the S&P 500.

The portfolio is a representative sample of the market because of its statistical insignificant difference from the movement of the index as shown by the p-value of 0.14 and its beta coefficient of $\beta = 0.84$, indicating how similar the portfolio moved over the two year period that it was assessed in relation to the index. Ultimately, Mad Money should not be used as a guide to investments, and instead should be enjoyed because of the entertaining nature of the show.

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