What You Know That Just Ain't So: *Working With Investment Professionals*

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

-Mark Twain

Over the course of their investing lives, most owners of substantial pools of capital will hear a large number of misstatements, partial truths, and out-and-out whoppers about investing. These ideas are typically part of a well-rehearsed sales pitch, often by someone who has a financial interest in getting investors to believe them. They may sound very seductive. Some have been bandied about so widely that they've almost reached the status of folk wisdom.

At best, such misinformation can cause investors to spend time and energy chasing after the unattainable — high return with no risk, for example. At worst, investors can end up losing money, and sometimes lots of it.

This paper is part of an ongoing series[1] by Beekman Wealth Advisory ("BWA") addressing common misconceptions about wealth management and investment practices. The goal of the series is to correct erroneous ideas, and to set forth the reality of what can and can't be achieved. Taking these flawed ideas with a large grain of salt will help investors steer clear of some potential dangers to their portfolios.

When it comes to **working with most investment professionals, here are two ideas that "Just Ain't So":**

1. *A good financial advisor should be able to get you to your goals.*
2. *There are investment magicians who know how to make money in every market — you just have to find them.*

Let's examine each of these dubious ideas in more detail.

Dubious Idea #1: A good financial advisor should be able to get you to your goals.

Most wealthy investors keep their goals reasonable. Sometimes, however, investors make demands that simply cannot be met. Consider these two real-life cases.

Case #1: The patriarch of a family in West Virginia came to see this writer many years ago about diversifying his family's portfolio. The family's assets consisted of one holding, about $5 million worth of a coal company stock. Several generations before, the family had sold its private coal mine in exchange for shares of the coal company they still held. The family patriarch requested a diversification strategy that would enable this pool of assets to support, permanently, the seven non-working members of his family, two of whom were in their 20s.

Case #2: A recent divorcee interviewed financial advisors, seeking assurance that they could invest her divorce settlement so as to generate a return of 12% per year, with minimal risk. That was the amount she felt was "needed" to live on comfortably.

In both of these scenarios, there's a real catch: Financial markets earn what they earn; they don't care how much an investor or beneficiary "needs" to live on. The investor who insists on a 12% return, in an environment in which financial assets are returning only half that much, is sure to be pursuing strategies that will put the principal at risk.

One recent example is subprime mortgage-backed securities, which appeared to offer a "free lunch." They carried AAA ratings from rating agencies, and yet offered much

[1] Additional presentations in this series may be accessed at www.beekmanwealth.com, or via request to info@beekmanwealth.com.

higher yields than those obtainable from other AAA-rated securities. Investors who bought those bonds for the higher yield wound up eventually losing much or all of their principal.

In each case, the investors described above were seeking to continue lifestyles that their portfolios simply could not sustain. In fact, most investment and trust professionals would put the sustainable spending rate (the amount that can be spent with reasonable assurance that the after-tax, after-inflation value of the assets won't be depleted over time) at no more than 3% to 4% of the value of a portfolio[2].

In the case of the West Virginia family, for example, a sustainable spending amount would be no more than about $200,000 per year — a handsome amount, but not enough to support seven people. Someone there needed to get a job — which was the advice given to the patriarch.

Wise investors set attainable goals. Wise financial advisors say "no" to unattainable ones.

BWA Truth #1: Sometimes you just can't get there from here. Sometimes, the goals need to be adjusted.

Dubious Idea #2: There are investment magicians who know how to make money in every market — you just have to find them.

Investment "gurus": The media generates a seemingly endless stream of them. Whether it's the hyperactive market seer with a television show and a host of predictions (some of which will actually prove correct), or the latest hot-handed hedge fund manager, or the quant with a "no-lose" investment algorithm, there's always somebody being lionized in the press for enormous returns, or a particularly prescient market call.

There seems to be a basic human need to believe that somewhere out there is someone with all the answers, someone who has it all figured out. And that, if we can just identify that person, or that idea, our lives will become so much simpler and more manageable. And so much richer, too, if the topic in question is investing.

Smart investors take all the hyperbole with a large grain of salt. One reason for skepticism is the fact that there ***is*** such a revolving door of gurus, most of whom seem to have a fairly quick time in the limelight before their "genius" is tested and found wanting.

Investment strategies that generate enormous short-term returns usually require taking equally sizeable risks—such as making a big, leveraged, one-way bet that pays off. The problem is that it is very difficult to make big, leveraged, one-way bets that pay off ***consistently.*** Big bets often backfire. Investors tend to hear about the successful bets, while the failures get much less attention.

There's a second problem for investors, which is that it is often difficult or impossible to gain access to those investment managers who truly deserve "guru" reputations. For example, George Soros, an extraordinarily successful investor over time, no longer manages money for any outside investors. Back when he did, an institution-sized minimum investment was required. Even Soros made some big mistakes — such as buying a stake in Lehman Brothers just before the investment bank went under in 2008.

Finally, making successful market calls, and making money, are often two different things. The analysts who publicly predicted the crash of the subprime market, and the investors who privately figured out how to profit from it personally (such as those brilliantly depicted in Michael Lewis's book *The Big Short)* were mostly two different groups of people, with little overlap.

BWA Truth #2: Magic wands are few and far between — and they don't get publicized.

Summary

At BWA, we know — from decades of experience — that investment professionals are both human and fallible. This means that there are limits to what even the smartest and best-intentioned advisors can accomplish. What investors can — and should — expect from their professional advi-

[2]For an explanation of the derivation of this rate, please see BWA's presentation on How *Not* to Become a Bag Lady.

sors, however, is open communications; clear explanations of what can be achieved, and collaborative relationships aimed at enhancing client well-being over the long term.

The business of managing wealth is by no means a simple one. There are no one-size-fits–all solutions, and too-good-to-be-true products are generally the ones to be avoided at all cost. Taking time to understand the client and his or her real needs, while acting in each client's best interests, has been the BWA way since the firm was established.

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