

## A Tale of Two Investors

By Brian Murphy  
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*It was the age of wisdom, it was the age of foolishness  
It was the epoch of belief, it was the epoch of incredulity  
It was the season of Light, it was the season of Darkness  
It was the spring of hope, it was the winter of despair  
We had everything before us, we had nothing before us...*



Sound familiar?

If not, you probably will recognize the line that preceded those above: “It was the best of times, it was the worst of times.” This prose, of course, comes from the opening of Dickens’ classic work, *A Tale of Two Cities*.

Although Dickens was depicting Europe in 1775, his dichotomy is eerily relevant today. Just as Dickens sought to contrast fortunes and misfortunes in England and France, today the divergence is painfully apparent in those who plan to accumulate wealth for their retirement and those who seek excess returns in their portfolios.

So begins a tale of two investors who just happen to be real clients of mine. Let’s call couple number one Mr. and Mrs. Passively Patient. They have traveled with me on my journey as a financial advisor and have been well served—in my opinion, at least—by the knowledge and experience I have gained over the past two decades. Let’s call couple number two Mr. and Mrs. Alpha Seeker. They were referred to me after the epic market meltdown in the fall of 2008.

The Patients are your classic affluent American couple. They are in their late 50’s; both are working professionals who have kids that are finished with college. Mr. Patient is a university professor with a handsome six-figure income, a generous benefit package filled with lifetime healthcare, a well-matched employer savings plan, and he wouldn’t mind working for the rest of his life because he is one of those rare folks who actually loves his job. Mrs. Patient is a medical professional with a thriving practice who is determined to serve the greater good of her fellow man. She sponsors her own



retirement plan, contributes regularly for herself and her employees, and wouldn't mind retiring in a couple of years.

The Alpha Seekers came into a tidy sum of money several years ago in their early forties after the selling a family business. They were guided into the arms of a highly regarded financial firm by their local legal and tax advisors and, for a few years at least, it was all about alpha. One could hardly encounter Mr. Seeker without hearing of a hugely profitable recent trade. In fact, it was rumored that their portfolio had nearly doubled at one point. Suffice it to say, things seemed very, very good to these inexperienced investors being guided by the excessive hand of their stockbroker.

The Alpha Seekers were leading a comfortable, if modest, lifestyle, but during the third quarter of 2008 they discovered one of the harsh truths of investing: It is a very sharp double-edged sword that cuts mercilessly in both directions.

As for me, I'm a former mainstream advisor turned passive investing zealot. Merrill Lynch hired me about a year and a half out of college and I went through what was then considered the best training program in the industry. Working through the local branch I did my time in the "cage," the wire room, swept floors, answered phones, but mostly studied for the Series 7 exam. Upon passing, I was whisked off to the more formal section of the training which included things like the "Selling Skills Seminar"—not, I should note, the "Make Money for Your Clients Seminar" nor the "Understanding the Financial Markets Seminar." No, the emphasis was totally and completely on prospecting and sales.

Eventually I went to New York City and attended classes at One Liberty Plaza, which now stands, as a stark reminder of the price of freedom, adjacent to the hole in the earth that we now refer to as Ground Zero. We studied every day, five days a week for three weeks and spent nearly every waking minute learning about how to create a prospect list, how to cold call and how to close.

No mention was made of concepts like asset allocation, risk, alpha, beta nor any other topic which might have saved my clients from the devastation caused by the market meltdown of October 1987.

Fast forward to 1998 and the founding of my own firm, an independent, almost exclusively fee-only RIA, which among other things is dedicated to avoiding the conflicts of interest that are so inherent in the investment industry. After getting caught up in the delusion that investment funds and managers that beat the market are predictable in advance, a growing awareness began to take hold during the Bear Market of 2000 to 2003. I came to grips with the error of my ways and began bringing my clients over to a more "passive" investment style, using Dimensional Fund Advisors along with ETFs and index funds to build client portfolios. Mr. and Mrs. Patient were among my first clients to make the transition.



In 2004 the Patients began to move slowly but surely to a portfolio laden with bonds and low-cost index funds slightly weighted in favor of small value stocks. The results were magnificent. Luckily, through new deposits and rebalancing, the portfolio remained true to its intention of maintaining value while growing in a measured manner when markets cooperated.

Risk, I had learned through experience, tends to be a voracious consumer of principal when one is caught unprepared. True, it may have been hard for Mr. and Mrs. Patient to be at the same cocktail party with the Alpha Seekers because they were riding the wave of huge returns from their concentrated investments in energy and commodity stocks. Their success, it turned out, owed more to a rising but decidedly cyclical worldwide economic tide than to the stock-picking ability of their "Lehman Brothers guy" in L.A.

Lehman, it turns out, was about to enter its own season of Dickensian darkness. As oil fell from \$150 to \$75 per barrel and the market began its nosedive, Lehman experienced its own mighty fall. All of Paulson's horses and all of Bernanke's men couldn't put Lehman together again. The most recent age of foolishness in investing had once again come to an end.

The Alpha Seekers learned a painful lesson at the hands of our Wall Street friends; they proceeded to lose over 60% of their portfolio's value. Soon after, they come knocking on my door, somewhat shell-shocked and looking for answers. Jim Cramer (a.k.a. "the screamer" of CNBC) and his buddies have trained the masses well: The Alpha Seekers were looking for my personal version of the alpha-seeking, magic formula to restore their lost wealth.

"We lost it all in energy stocks, but can we make it back in precious metals?" they asked me at least once. Luckily for them and for me, by that point we were armed with what I believe to be the best tool the industry has ever developed for answering the all-important question every wealth manager has to answer for their clients: "Am I okay"?

Don't laugh. As you contemplate the layers of this question, you will come to understand its extreme and never-ending relevance. Clients aren't just asking, "Am I okay today?" No, what they mean is, "Am I okay forever, am I saving enough, am I spending too much, and am I sacrificing my lifestyle by saving too much or not spending enough? Are my kids okay? My grandkids, my favorite charity, my alma mater?" You get the point.

The real magic of our financial advising process is that it is dynamic, with data continually updating for fluid goals and changing markets. I have always had an affinity for the truth, and there is no better way to start a dialogue with a client than, "Here's where we started, and here's where we are headed until something changes." You



know – those little changes that crop up like market meltdowns, job losses unforeseen medical bills and all the rest.

Unlike financial planning, which tends to be static by nature, our process updates each and every quarter. I don't just ask my clients a set of sterile questions one time and then walk away. After spending many hours asking poignant and relevant questions and explaining the futility of trying to beat the markets, we began the process of transferring Mr. and Mrs. Alpha Seeker's battered and bruised accounts from Lehman.

But the process didn't end there; it just began. After determining their probability of excess, we were compelled to uphold their relatively high equity exposure—and thank goodness we did, even when Mr. Alpha nearly lost his mind in early March of 2009 when the market dipped all the way down to 6500. Sure, it was tough, but we had eliminated opinions and replaced them with cold hard facts; real probabilities, not just hunches.

Remember, this is the tale of two investors, and they had very different experiences, but now their future probability for excess is not tied to anyone's ability to pick stocks, funds or beat the market. No, what these stories of two very real families have in common is the commitment to frame the conundrum we all face with absolute truth and real discipline.

Mr. and Mrs. Patient survived the downturn of 2007-2009. As the Dow fell from roughly 14, 000 in 2007 to nearly 6,500 in March of 2009, they were happy to run into their alpha-seeking friends at cocktail parties. We helped the Patient family replace anxiety about the present with confidence in the future success of their plans, and when the chips were down, we were all pretty pleased. Giving money away in the markets is never enjoyable, and this time around we gave back a lot less.

The journey has not been nearly as fun for the Alpha Seekers, but when their financial plan dictated a need to maintain high equity exposure we did it. It wasn't easy but it paid off nicely. Both Mr. and Mrs. Alpha have needed a bit of handholding along the way. But I come armed with facts behind the science of investing and the probability of excess rather than just a bunch of Wall Street research designed to create velocity of trading and investment banking fees.

One more thing; from the very beginning we told Mr. Alpha Seeker the truth: that he needed to return to the workforce. Rather than look the other way and allow this family to drain their nest egg, we faced to truth together and today the Alpha Seekers might well be renamed the Little Landlords, as they have begun to accumulate and manage a stable of rental properties that generate steady cash flow and help to both pay bills and create future wealth.



In the end, both the Alpha Seekers and the Patients will be “okay.” While we may now be exiting the “age of foolishness,” surely it will one day return and some new form of madness will overtake Wall Street and perhaps the rest of the world. Regardless, my clients will be “okay” nearly 90% of the time—based on fact, not fiction. Not because we beat the market, not because we found the best money manager, and clearly not because we over-weighted energy, alternative investments or any other Wall Street nonsense.

No, we will be “okay” because we don’t swing for the fences only to strike out in the bottom of the ninth inning. We added a dynamic financial advising process and the discipline to use it properly to our arsenal, and now we all sleep a little better at night.

*Brian Murphy is the founder and CEO of Pathways Financial Partners, a Tucson, AZ-based advisory firm, and uses Wealthcare in lieu of traditional financial planning.*

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