



## **Casting No Stones**

By Bob Veres

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I've been having the same discussion lately with a variety of advisors, and sometimes the conversation gets heated. So I'd like to lay out my position here for all to see, and maybe this will start a useful dialogue.

The discussion usually starts when I am approached by an advisor who jumped out of the market sometime before November, and in some cases before September of last year--and when I mean "jumped," I mean took client equity positions down to 20% or less. These advisors are still sitting on losses, but they aren't nearly as significant as what most of us are looking at in our retirement portfolios. And now, when I ask them how they're doing, they immediately, sometimes eagerly, tell me that they paid attention to the economic signals and avoided most of the wreckage, and how (they ask me) can other advisors call themselves financial planners when they were too ignorant to see this train wreck coming?

This always starts the argument. On my side, I point out that a few others missed these obvious signals too--people like Hank Paulsen and Ben Bernanke and Warren Buffett and, oh, maybe a few hundred million others, and on their side they say that most financial planners are brainwashed zombies who would buy and hold even if we declared nuclear war on China, and that advisors, if they are REAL advisors, need to pay more attention to the economy and valuations and everything else so they can protect their clients.

Inevitably, I agree that, yes, more investment sophistication is needed. But I also ask them when the upturn will begin, and I have yet to get a consistent answer.

My sense is that there is some truth to what these people are saying. The financial planning community has been gliding on a kind of investment auto-pilot for way too long, and that planners of the future will either delegate their investment management activities, either through actively-managed mutual funds that have a broad mandate to shift their allocations if they think valuations are out of whack, or to some of these financial advisors who live and breathe market and economic statistics and who incorporate valuation measures into modern



portfolio theory. (Is the market safer with a PE of 8 than it is when PEs are running into the 30s? If you answer 'yes,' then you should probably be paying attention to these valuations and structuring client portfolios accordingly--though, frankly, I still have no idea what the precise recommendations should be.)

I also, however, think that this is not exactly a perfect time to be switching investment philosophies. Even if you *are* a convert to what these sage or lucky advisors are now preaching, does that mean you should switch allocations to something more conservative now, when valuations are low?

I think there are four kinds of investors roaming the streets these days. First, there are the investors who were lucky enough to work with an advisor who sidestepped this mess, and we will see if their advisors are skillful enough to get them back into the market when it gets bullish--and that probably means navigating around who knows how many sucker rallies before we hit the real thing. Second, there are the clients of advisors who maintained their investment allocations and rode the roller coaster all the way down, but who are going to stick it out and give their clients the benefit of riding it back up--and I have yet to talk to anybody who thinks the market will stay down forever, so we seem to agree that there WILL be a recovery that will eventually make everyone whole.

In third place in this race are the consumers who panicked last September or October and fled the market, and who are probably boasting to their friends that stocks are just too risky. They'll watch a sucker's rally go by and enjoy the subsequent downturn, feeling safe in their cash position. They'll watch another one, and then they'll smugly watch the bull roar upward until, somewhere near its peak, there is so much frenzy and excitement, and so much regret at how much upside they have already missed, that they'll put their money in near the top and end up far worse off than they were before.

Finally, there are the clients of advisors who will lose their nerve; who gave their clients the full brunt of the downside in a buy-and-hold posture, and then will decided to give up and take an ultra-conservative position. They will lock in losses, and be caught by surprise by the sudden, unexpected bull run, either mistaking it for another sucker's rally or simply not having cash in the market in time to catch most of the updraft. The clients of those advisors will have suffered most of all.

Like it or not, even if you now believe there are ways to evaluate the future returns of this or that asset class, even if you think you learned something from this bear market and that there is something to what these sophisticated advisors are saying about sidestepping the worst of the bear, you're really trapped into offering your clients the second best of four alternatives--and, if those advisors



casting stones fail to recognize the next bull, you may actually wind up with the best of the four.

I may be wrong, but I believe that the only sensible time to make dramatic changes in your investment philosophy is toward the end of a bull market, when high valuations are making you uncomfortable and your reading of the economic tea leaves leads to disturbing conclusions. I think when that day comes, many of the advisors that are being castigated and dismissed by their peers will actually have a better solution than they did this time around. Moreover, I agree with the successful sidesteppers that it will become accepted wisdom throughout the profession that correlation coefficients, mean variance calculations AND valuations need to be taken into consideration when assessing the opportunity set offered by the markets.

That day isn't here yet. I readily congratulate the advisors who managed to sidestep the worst bear market since the 1930s, and I am happy for their clients. But I'm not ready to throw the other advisors under the bus for sticking to their principles when the alternatives look like they do today. In my own portfolio, I have no idea when the next bull market will come, but I intend to ride it up from the very first moment it appears, and I know only one way to do that: grit my teeth, maybe wish I had been smarter, and hold on to the handlebars of the roller coaster to wherever it takes me next.

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