



In Search of Unconventional Thinking

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Dreary economic forecasts will sap your clients' enthusiasm for investing. One clear way to overcome this hurdle is to adopt a contrarian attitude toward interpreting news and analysis.

Many academics describe the stock market as a highly efficient discounting mechanism – in theory if not in practice, share prices should reflect everything we know about the future.

That's why astute investors search out insights that aren't reflected in stock prices. For this to work, though, you have to be prepared to differ from the pack and defy conventional thinking – once an idea enters the mainstream, it no longer gives you an edge.



For example, investors who were early in identifying the potential of the internet and positioned themselves in tech stocks in the mid-90s ended up doing well; the latecomers who jumped on board in 1999 or 2000 had their heads handed to them.

Which brings us to where we stand today.

Despite all the attention to the “green shoots” popping up around us, the global economy still faces formidable challenges. With downbeat forecasts for growth and demand, unemployment, corporate profits, commodity prices and budget deficits as well as looming inflation concerns, the runup in markets since March 9 may mean the good news for the next while is already reflected in stock prices.

That's why a growing school of thought says we're in for a “range bound market” for the next few years, moving up and down in a relatively narrow sideways band. Under this scenario, you will have to work much harder to make money for your clients.

Extend your horizon out three to five years, however and it's a different story – I can make a strong case that today's stock prices don't fully reflect important positive elements in today's news.



The role of innovation

Even with cutbacks in corporate spending, we're still seeing huge investments in research and development around the world. When the U.S. market seemed stalled in 1989, Sir John Templeton defied convention and made large returns for his investors by expressing optimistic views - in part, he said, because more scientists were working at that point in time than had lived and worked from the beginning of humankind until about 1900.

That's even truer today. And it's not just the number of researchers - with computing power and the instant dissemination of the latest discoveries via the internet, scientists are ever more productive in their pursuit to solve the most difficult and challenging problems.

The stock market only reflects what we know – and by its nature has difficulty accounting for the effect of innovation.

In 1980, for instance, conventional wisdom held that the growth of the computer industry, which had been a good business in the 1970s as mini-computers replaced mainframes, would slow going forward. Almost no one saw the personal computer revolution coming. And in 1990, mainstream thinking said that computers had been a great business in the 1980s but would slow going forward, as most companies had purchased all the computers they needed. No one saw the rise of the internet and the evolution of the computer as a universal home appliance.

More recently, Apple's stock price has been a great performer – largely because nobody foresaw the iPod or the iPhone. In the next few years, there are going to be many cases like Apple, as companies cash in on investments in research and development.

The drive to succeed in developing markets

Next, consider the educated youth and emerging middle class in many developing markets - not just China and India, but Indonesia, Malaysia, much of South America and parts of Eastern Europe.

Like many business people who travel to these countries, I am amazed by the work ethic, inventiveness and ambition among the middle class and younger generation. I also see this among the foreign students in the MBA classes I teach at the University of Toronto.

With a move to open markets and lower trade barriers around the globe, these countries will provide existing industries and Western youth with formidable competition. Yes,



their urban-rural divide and distribution of wealth create societal tensions, but at a macro level these markets will be a huge driver of global growth.

The resiliency of the American psyche

Some investors outside (and even some within) the U.S. have written-off the US as a fading empire. Certainly America faces lots of issues with reduced consumption levels, increased savings rates, the declining quality of education and healthcare systems, a seemingly permanent underclass and record budget deficits.

Despite this, the U.S is still the Promised Land for the best and brightest from around the world and, social mobility data across generations proves that children are increasingly successful relative to their parents. The US is the closest there is to a pure meritocracy.

Unlike past empires (Great Britain in the nineteenth century, the Soviet Union in the twentieth), American industry has maintained an unrelenting drive to win – with the goal of not just beating competitors, but driving them into the ground. Over time, it has shown the ability to shake off the complacency that comes with success and reinvent itself, deal decisively with bad news and make tough decisions, embrace risk and accept failure.

Yes, the auto industry is one (and not the only) exception, but at the other extreme is the remarkable concentration of the global high tech industry in the United States. Think about how Walmart transformed retailing in much of the world; it's hard to visualize Walmart emerging anywhere else.

The U.S., like all successful societies, has its share of arrogance and ignorance (fairly or not, this was seen by many outside the U.S. in the last Bush administration) but anyone who underestimates the American capacity for renewal and is making a grave miscalculation.

The bottom line – we need to help clients understand that getting superior returns requires going against the grain and having the foresight, discipline and conviction to first seek out and act on insights that others are missing.

In markets like these, it's easy for investors to get caught up in the latest pronouncements by the cable-TV oracles. When this comes up in conversation, remind clients that these so-called experts are typically prisoners of convention and anything they tell you they're also telling millions of others - and the last place you're likely to find fresh insights is on CNBC.



** Dan Richards conducts programs to help advisors gain and retain clients and is an award winning faculty member in the MBA program at the University of Toronto. To see more of his written and video commentaries and to reach him, go to www.strategicimperatives.ca.*

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