



It's No Shell Game

The \$100,000 Challenge to Passive Managers

By Roger Schreiner

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Two weeks ago Roger Schreiner of Schreiner Capital Management wrote, [The \\$100,000 Challenge to Passive Managers](#). Last week, Dave Loeper of Wealthcare Capital Management responded to Schreiner's challenge saying he "stacked the deck" to make his challenge un-winnable, and offered his own, [\\$2 Million Charity Challenge to Active Investors](#). The following is in response to Mr. Loeper's article.

Last week David Loeper accused me of "playing a shell game" and "stacking the deck" in my [\\$100,000 Challenge to Passive Managers](#). He attempted to discredit me by misinterpreting and misstating the rules of my challenge. The rules I laid out are simple, but you wouldn't know it by reading Loeper's criticism. I was clear: "In order to win the contest, a portfolio must have *both* higher return and lower risk. To calculate risk and return, we will use the statistical measures of total return and daily standard deviation."

If the playing field isn't level, it's because of the ridiculous burden that every passive investor imposes on himself! By definition, a passive investor has no flexibility. They rely on diversification as their only risk management tool, a problem I wrote extensively about in a recent article, [Diversification is Not Enough](#).

A passive portfolio has no escape plan, no way to effectively manage risk in a systemic crisis, and no way to defend itself against a market crash. Passive investors place their unwavering faith in the stock market, close their eyes and cross their fingers. The fact that passive investors do not allow themselves the ability to move to cash is their choice, not mine! Is that what you call stacking the deck, Mr. Loeper? The burden of the passive investor's own choice? It's ironic that active management is said to be more risky. In reality, the opposite is true.

One thing I have learned in my thirty years as an investment advisor is never to make a bet unless the odds are in your favor. Only a fool bets against the odds. If a passive investor is willing to relinquish control over their portfolio while allowing me to actively manage mine, I'll make that bet any day.



It has been 193 days since John Bogle received my challenge by certified mail and almost six months since I opened my challenge to all passive investors. So far, no one has accepted. As I expected, a few people, including Mr. Loeper, have criticized me. But talk is cheap. As I stated in my original challenge, more debate cannot settle the longstanding dispute between active and passive investors. It's time to put up or shut up.

Passive investors continue to miss the point. Any approach that willingly accepts losses of 30, 40, 50 percent and more is reckless. Active management may be difficult, but that's no reason to assume unnecessary risk. Passive investing is not something to accept just because the alternatives require hard work and skill.

Loeper points out a number of strategies that I could use during the contest to ensure that I won't lose. None of these would guarantee that I win, mind you, which Loeper fails to admit. I could move my account entirely to cash, simply put 5% in cash, or I could replicate the passive portfolio most of the time and then move to cash near the end of the contest.

I would do none of these, because it would not be in the spirit of the contest. I would employ the same disciplined trend-following process I've been using for our clients for over twenty years. But nonetheless, thank you, David! You've proven my point! You've discovered for yourself what so many fail to recognize: that active management has an inherent advantage over passive investing. In your attempt to mock me, Mr. Loeper, you have helped me make my point. The ability to actively manage market exposure makes my process superior to any passive one.

The focus of my challenge is squarely on risk management – specifically, risk reduction. It's not about my ability to forecast the markets. I claim no such ability. Our investment strategy is to own stocks when the market is strong and sell them when the market is weak. By comparison, the investment process (if you can call it that) of the passive investor is embarrassingly simple: hope.

Mr. Loeper, I read your challenge carefully. Compared to mine, it's complex. There are a lot of rules, and it does not address investors' main concern: the risk of loss. Leave it to a passive investor to ignore the 800 pound gorilla in the room.

The vast majority of investors (especially older ones with significant wealth) will tell you that asset preservation is their number-one priority. Warren Buffett agrees. He often reminds investors of his two rules for investment success: "Rule #1: Don't lose money. Rule #2: Don't forget rule #1."



The greatest threat to investors is uncertainty of the future. It's the next crisis – the next black swan. If you accept buy-and-hold, you are accepting that, at some point, your retirement savings will experience a devastating loss or series of losses. The ten largest stock markets in the world have all crashed more than once. And the bigger they are, the harder they fall, it seems. The two largest have also experienced the largest declines. In the U.S., the Dow fell 89% from 1929-1932 and in Japan, the Nikkei has fallen 82% from it's all time high in 1989 to the recent low in March of last year. Next week we will publish an extensive look at the troubles in Japan, which once boasted the largest stock market in the world. I always tell investors, "If your investment process does not include an exit strategy, you shouldn't be invested in the stock market."

My challenge is straightforward and fair. I leave most of the options to my passive challenger, including the length of the contest. I even allow them to choose the assets in their portfolio *and mine!* And I saddle myself with a two-percent management fee while waving all management fees for the passive portfolio. Loeper says I'm "stacking the deck?"

David, you should stop posturing and debating and accept my challenge. If you do, you must be willing to consider risk *and* return like a real-world investor. The results should be measured by *return*, (dollars of wealth), and *risk* (standard deviation). Bring it on, my friend. My charity could use your support.

Roger Schreiner is the founder and CEO of Schreiner Capital Management, Inc. (SCM), an SEC-registered investment advisor located in Exton, Pennsylvania. SCM is a third party investment manager and sponsors the Select Advisors Wrap Program, an investment platform that provides active investment solutions for Advisors and their clients.

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