



Letters to the Editor

March 9, 2010

The following are in response to last week's article, [It's No Shell Game](#), by Roger Schreiner, which was in response to Dave Loeper's article the previous week, [The \\$2 Million Charity Challenge to Active Investors](#):

Mr. Loeper,

If you want to make the playing field more realistic, you would not set up your challenge based on "dollar cost averaging" (a \$10,000 deposit *each* year). Investors' cash flow behavior *varies*. A better challenge would be to have three scenarios – one with a lump sum deposit, one with annual contributions (per your original proposal), *and* a third, (more pertinent to retiring boomers!) with annual *distributions*!

Why not analyze how a varying "sequence of returns" will affect *that* last scenario! Too many advisors and investors still *do not* understand this reality.

Why not discuss and propose these scenarios for a more realistic challenge of active versus passive investing.

What do you say?

Sincerely,

William E. Sawyer, CFP®
Conservative Asset Management, Inc.
Louisville, KY

Dave Loeper responds:

Bill:

I agree that each client has different cash flow needs, desires, and goals. The timing risk of when returns occur will impact the outcome. In some cases there is a positive impact and sometimes there is a negative impact, but it has nothing to do with the fiction of dollar cost averaging.

The scenario I proposed was a real scenario...people *do* accumulate money towards future goals. For you to win that bet, you would have to make sure you do not underperform in the last two or three years when there is a lot of money at



stake. Ironically, my proposed bet still stacks the odds against me because if you outperformed at any time along the way, all you would need to do is replicate our portfolio for the remaining period to make sure you do not underperform after most of the wealth has been accumulated.

If we modeled a client with the goal of distributions, you had better make sure you don't underperform in the first couple of years when the client portfolio is at peak wealth.

I'll gladly accept your bet provided we choose *one* client scenario instead of several where random luck of when superior or inferior returns occur will no doubt produce at least one winner for you. How about one that accumulates for five years and distributes for five years? You better hope your investment style doesn't underperform in years four, five or six. Can your active management approach control which years in a life-goal plan you will outperform?

You are basically admitting that "superior" market relative returns represent no real value to any particular client because you have no control over whether an active management bet will be a win for any particular client, even if it wins on a risk and return perspective. What is your value to a client who is distributing wealth when you underperformed the year they were at peak wealth? What is your value to a client accumulating wealth who was harmed by underperformance during later years?

Active management continuously subjects the investor to a risk of underperformance at the wrong time for their unique wealth plan. Hopefully, when you make such gambles you accurately disclose this risk to your clients and share the reality with clients that the risk of underperforming at the wrong time can be avoided with certainty by indexing.

We are about managing the wealth of each unique investor's life goal plan. I can't do that if I subject them to uncertain timing of market relative returns. As you acknowledged, nor can you.

David B. Loeper, CIMA®, CIMC®
President/CEO
Finaceware, Inc. DBA Wealthcare Capital Management
Richmond, VA



Dear Editor,

I echo Roger Schreiner's sentiments. Paying an advisor to "buy and hold" your investments rather than employing an active risk management strategy is akin to hiring a judge to simply follow the letter of the law.

We are paid to interpret the potential risks and returns of the stock market and make decisions in the best interest of our clients.

I doubt passively accepting 30, 40, and 50 percent investment losses and hoping for an immediate recovery would be in any client's best interest.

No wonder these black box annuities are flying off the shelves!

Maurice Wilson
Wilson Wealth Management Group, LLC
Charlotte, NC

The following is in response to Michael Nairne's article, [The Elusiveness of Persistence](#), which appeared last week:

Dear Editor,

I took much interest in your article *The Elusiveness of Persistence*. Past performance does not guarantee future success in selecting managers. I agree entirely with this statement.

However, I disagree with the conclusion that you should then go to low cost index funds or ETFs. The answer to finding a good manager is to evaluate their style and the companies that gave them the good performance in the first place. With ample analysis, one can determine style, growth or value, sector, momentum and other factors that produce the performance. Then one can gauge whether this style is likely to be a winner or loser in the future. This can allow investors to still beat the index funds.

Brett Winnefeld, CFA
Director of Equity Research
Howe and Rusling
Rochester, NY



The following is in response to Dan Richards' [interview](#) with Robert Pozen, which appeared last week:

Dear Editor,

Great article with Mr. Pozen (as usual), but it appears Mr. Pozen might want to review how Morningstar calculates its ratings.

Since they are based on trailing periods, the 10-yr, 5-yr and 3-yr returns all contain the performance of the last three years. So the three-year return has a huge impact on the overall rating.

For a simple example, consider the Muhlenkamp Fund (MUHLX). Its 10-yr return is in the top 17% of its category, yet has a two-star rating. Why?

It was in the bottom 13% over the last three years and in the bottom 2% for the last five years.

And there's also a risk component to the ratings as well, which is a bit complex but also based on the trailing periods.

So while having a great 10-year record is helpful, you can't hide recent underperformance, as Pozen suggests. Mr. Muhlenkamp was clearly hurt by his poor three- and five-year performance.

(This just happens to be a fund I watch. I'm sure a simple Morningstar search can find others.)

Keep up the great articles!

Michael T. Karbouski, CFP®
Vice President
Wealth Management
Securant Bank & Trust
Elm Grove, WI



Lastly, the following is in response to our article, [Interest Rates, Inflation and the PIMCO Total Return Fund](#), which appeared two weeks ago:

Dear Editor,

Thank you for such a relevant and well positioned paper on the PIMCO Total Return fund specifically, and on the pros and cons of fixed-income funds in general in this market environment. Your articles are definitely a cut above all the other "stuff" I receive. They are well researched, comprehensive, and more than the typical superficial fare. Keep them coming and feel free to use my comments as testimony to your content quality!

Amy Lampert
The Lampert Advisory Group/WomensWorth
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