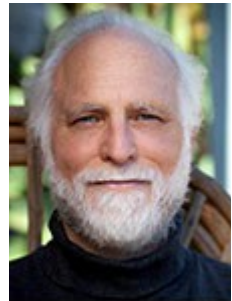


## The Ten Key Benefits of Investment Committees

By Bob Veres  
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In the past decade, a new phenomenon has swept the RIA landscape. Without fanfare, acting independently, thousands of independent advisory firms have created investment committees to oversee their asset management processes. The trend seems to have begun after the so-called Tech Wreck that burst the dot-com bubble in 2000, and it accelerated as advisors sought to improve their investment processes following the market meltdown of 2008.



Bob Veres

To date, however, very little has been written about investment committees. How are they organized? How do they work? Why would advisors even think of mimicking the investment practices of stodgy competitors like trust companies, endowments and foundations? "I sat on investment committees for four different trust institutions," said Dan Danford, of the Family Investment Center in St. Joseph, MO. "I do think that the system provides some helpful checks and balances, but decisions by committee are often dysfunctional and usually dismiss outlier ideas."

To learn more about investment committees in the advisor community, I sent a survey out to the readers of my Inside Information service. The picture that emerged from more than 150 responses was confusing at best. It appears that the investment committee has become a Swiss Army knife in the RIA world, with different advisory firms using it for very different purposes.

In this first part of a two-part report, I'll identify ten core purposes that investment committees serve in different types of firms, ranking them in order of the number of responses I received. If your investment committee is serving all ten purposes, based on the survey, you're among a select minority – which means that many advisors may find new ways to use this versatile new tool in their RIA practices.

### **#1: As an administrative convenience for growing practices**

As advisory firms grow and add advisors, it becomes increasingly difficult to standardize their investment recommendations across the firm. It gets harder and harder to avoid the compliance problems associated with giving different advice to two clients with similar profiles. One advisor may tell a client one thing about the investment markets, and another may give a contradictory view at a subsequent meeting.

Several respondents said that a centralized decision-making body makes it easier to get everybody on the same page. "The primary purpose of our investment committee is to keep the investment process systematized across all professionals, so that each client



gets the same standard of care no matter which professional is their primary advisor," said Rick Adkins, of The Arkansas Financial Group in Little Rock, Ark.

David Morganstern, in Portland, Ore., talks about using the monthly discussion to harmonize disparate viewpoints. "Much of the benefit [of an investment committee] is to calibrate among partners as to our philosophy and investing practices," he said. "We are working on establishing a consistent 'client experience,' so we're investing essentially the same way for all of our clients – not developing one-off portfolios."

And, of course, some advisors subscribe to the simple idea that many heads are better than one when it comes to making increasingly complex investment calls. "Our Investment Committee provides a forum for investment ideas, strategies, and products to be discussed critically and chosen carefully before they are used in client portfolios," said Peter Eickelberg, of Keats, Connelly & Associates in Phoenix, Ariz.

## **#2: To gather a broader perspective on investment decisions**

In the second half of this report still to come, I'll look at how investment committees bring in outside data to inform their discussions. But a number of advisors said that they improve investment decisions simply by opening up their discussions to include the very different perspectives of various members of their staff. In most of the responses, that meant that, in addition to dedicated investment professionals, the committee would include the firm's non-owner advisors, who are expected to raise issues that clients themselves might ask about.

But some firms have taken the idea of inclusiveness further than simply inviting client-facing advisors. "We make sure that all constituencies – research, financial planning, compliance, trading, the voice of the client – are represented when we make decisions to alter target allocations or make investment recommendations in general," said Greg Friedman, of Private Ocean in San Rafael, Calif.

Friedman was one of many who talked about the way different professionals can inform the investment decisions. "In a vacuum, you may decide that some new investment will reduce expected risk for the same return," Friedman added. "But if you take a broader picture, that may not work as well as you hoped." While the investment people are looking at returns, the tax specialist will be mulling tax consequences and whether the idea is suitable among taxable investments or only appropriate for tax-free accounts. The advisors are speaking on behalf of client issues – is the proposed investment so complex that clients won't understand it?

Friedman's investment committee also includes the back-office staffer who handles trading, which he said has brought a lot of value to the process. "When we come up with something," he said, "he might say, 'Do you know what it's going to take for us to



implement that?' There are things you don't realize until you get the operational perspective."

### **#3: Sharing a growing investment research workload**

The idea of sharing duties may sound obvious, but in fact using investment committees this way is part of a larger trend. After two market debacles in a decade, RIA portfolios have become more complicated to manage. Many advisors are venturing into esoteric "alternative" funds that require additional due diligence. They may also be applying top-down tactical overlays to the strategic allocations, which require economic research and data.

Many of the respondents said, in one way or another, that the workload of staying on top of everything that has to be monitored closely had become too big a job for the founder/owner to handle alone. For example, at RegentAtlantic Capital in Morristown, N.J., investment committee chair Brian Kazanchy listed the committee's purpose as performing all the investment due diligence and risk management tasks necessary to construct, implement and monitor client portfolios.

Others said that, with the markets jumping around more frequently, the half-life of an investment holding is decreasing, forcing more-frequent (and just as time-consuming) evaluations. "Our committee forces us to make sure that the investments we've chosen to fill each 'investment bucket' are still performing appropriately as a proxy for the asset class they represent and that the funds are performing competitively with other options within their bucket," said Adkins. "We also watch to see if changes in structure, fees or management are likely to adversely affect clients."

Even traditional time allocations are being streamlined. "We've used our investment committee as an opportunity to reduce the number of investment team members meeting with investment company reps," said Elaine Bedel, of Bedel Financial Consulting in Indianapolis. "One person meet[s] with the rep and then update[s] the committee if they found anything from the meeting interesting or worth looking into."

### **#4: Forcing staff to pay attention on current economic and market events**

Since the 2008 meltdown, many clients expect their advisors to stay on top of the markets and take action before the next Lehman collapse or a debt crisis in the Eurozone. In meetings, clients are looking for signs that the advisor is paying close and frequent attention to the investment landscape. Serving on an investment committee guarantees that the participants will periodically discuss the current state of the economy and markets, rather than burying their noses in financial planning minutiae.

"One of our IC's most important purposes is one of education and information sharing," said Norm Boone, of Mosaic Financial Partners in San Francisco. "I want all of our people



fully conversant on investment issues so they can easily and thoroughly discuss the issues of the day and our company's investment philosophy. If they've heard the IC debates – and I encourage them – then they know both sides and are prepared for client questions and concerns."

#### **#5: Imposing discipline on the investment process and serving as a check against emotional or impulsive decisions**

Maurizio Capra, who practices in Milan, Italy, said that his IC's goal is simply to arrive at more professional investment decisions. "The idea is to frame a disciplined process in order to make ... erudite mistakes," he said, with tongue firmly in cheek.

"Our goal was to bring structure to the investment decision process and eliminate 'gut' decisions," said Mark Lamontagne, of Ryan Lamontagne, Inc. in Ottawa, Canada. "Before we had an IC, I looked at the portfolios of the three partners at my firm and found they were very similar because of water cooler chat, though everyone always seemed to have some unique ideas."

Randy Brunson, who practices in Atlanta, said that one purpose of his investment committee is to avoid rash or emotional decisions. "We can help prevent each other from jumping into something which may have effects we hadn't thought of," said Bart Metzler, in Cincinnati.

One advisor, who asked to remain anonymous, noted on the survey form that before his firm's investment committee was created all investment decisions (adding, overweighting or removing asset classes, changing funds, etc.) were made by the company founder at what seemed, in retrospect, to be random points in time. "He is a very smart and successful man," said the advisor. "However, there was absolutely no framework, nor checks and balances, surrounding his whims and ideas."

Indeed, an investment committee may also represent a helpful step toward moving some absolute power to make decisions out of the hands of the RIA's founders. "There is a lot of control given up by individual actors when you go to an investment committee," said Melissa Joy, at the Center for Financial Planning in Southfield, Mich. "I remember one peer at another firm whose jaw dropped when we told him that we have an investment committee that doesn't include all firm owners. He couldn't imagine giving up that control."

"Moving from an ensemble practice in name to an ensemble practice in action was part of the process for us," she added. "Without making that transition, you can have a committee which is much less effective than intended."



## **#6: Helping to frame a consistent investment "story" about a firm's investment philosophy, thereby fostering better communication with clients**

Ideally, the time spent brainstorming and debating at investment committee meetings brings increased clarity, which will carry over outside the committee room. "The investment committee should function as a way to foster consistent and intelligent communications and conversations with clients," said Dana Anspach, of Sensible Money, LLC, in Scottsdale, Ariz.

Liam Molloy, of Galway Investment Strategy in Charlottesville, Va., said that it has become increasingly important for advisory firms to communicate their investment philosophies clearly to clients, who are constantly barraged with dark headlines about fiscal cliffs, eurozone defaults, and unemployment. "If the committee is able to formulate clear consensus ideas out of its research and data, then the story that you tell clients becomes much more reassuring," he said.

## **#7: To boost the firm's marketing efforts**

At a time when clients are looking for advisors who are able to navigate the new investment reality, the effect a committee can have on client perceptions should not be overlooked.

Casey Bear, of Cranbrook Wealth Management in Troy, Mich., thinks that the trend toward creating investment committees may be more a matter of style than substance. "A smaller firm," he said, "can sound bigger and better when you talk about your 'investment committee' – even though, for 95% of firms, it is the founder and his [or] her 27-year-old associate going out to lunch once every 90 days."

Capra, in Italy, has an interesting variation on the standard model: He invites his clients to take part in his investment committee meetings. They seem to enjoy it, and it's another way in which, he said, "the committee instrument becomes a marketing tool."

## **#8: To educate key staff members**

Just as the investment committee helps the firm formulate its portfolio-related messages to clients and develop a firm-wide perspective, it can serve a similar function internally. Elyse Foster, of Harbor Financial Group in Boulder, Colo., said that her investment committee has become her way of teaching the younger advisors how the investment decision-making process works. Boone – the San Francisco-based advisor who likes how his investment committee keeps everyone apprised of current events – also noted that his committee helps newer staff members understand the "why" of portfolio decisions.



### **#9: To monitor very specific aspects of client portfolios that are unique to a firm**

This purpose, inherently, may not apply to all firms, but the survey uncovered one intriguing (and detailed) example. After reviewing the performance of individual investments in client portfolios and measuring the upside and downside capture ratios for all risk categories each week, the investment committee at Ron Rogé & Associates in Bohemia, N.Y., will look at the clients' net cash position – which, said Ron Rogé, should be between 3% to 4%. "We instituted this because I noticed we were running higher-than-normal cash positions from time to time," he said. "So I decided to measure and report on it once a week. Now we rarely have higher-than-normal cash positions. As the saying goes, what gets measured and reported gets done."

Rogé's IC has also developed a very efficient process that catches errors or problems before the client notices. As a matter of committee routine, the members will look at a report which breaks all clients down into individual risk categories, and measures the mean and mode of each client's overall performance compared to the others in that category. "We have a chart showing all clients in the category, with each client's performance that week and the previous week," he explained. "We're looking for outliers. If we find one, we drill down to that account to determine why it was an outlier that week. Our methodology allows us to review almost 300 portfolios in less than 15 minutes per week."

### **#10: To serve as a think tank and portfolio laboratory whose goal is to identify ways to outperform the market on a risk-adjusted basis**

Based on the respondents in my (admittedly small) sample, surprisingly few advisors seem to be using their investment committee as a tool to generate better-than-market returns.

But those who do have evolved labor-intensive processes. Phil Taggart of Taggart Financial Group in Houston assigns individual committee members to review and watch different areas of the market, and they are supervised as to what indicators they should be most closely monitoring. "As complex as the market is today, the more market-watchers you have, the better off your firm should be," Taggart said. "We think that exchanging information is absolutely vital."

His investment committee itself has just two members. One monitors the information coming in regarding equities, equity ETFs, the market direction, and world geographic and investment sectors. The other is broadly assigned to fixed income, market technology, mergers and acquisitions, the Federal Reserve and major indices.

"Information is shared by email and telephone once a trend is developed and confirmed," said Taggart. "There are many, many false indicators in the market today. We have five-day, ten-day and 20-day watches and then overall confirming trends of up to 60 days.

Trend continuity is just as important as beginning and end points." The investment committee dialogue tends to create an internal sense of urgency in rebalancing portfolios,



avoiding certain securities, issues or ETF areas, and focuses attention on those sensitive time periods--such as the end of the bull market in bonds—where the company can add value and return.

Ken Solow, at Pinnacle Advisory Group in Columbia, Md., oversees a process that actively changes the asset allocation of five different model portfolios based on a consensus view of the economic cycle, technical market conditions and traditional valuation measures. "We work within a 'risk budget,' which gives the team extraordinary latitude in trying to find good investment values," he said, adding that part of the committee chair's role is to measure the "conviction" of the team about current market conditions.

In an effort to improve market performance, the firm has hired four analysts who spend 100% of their time making investment decisions. "Over many years, we have developed a culture where analysts know they are required to offer informed and independent opinions about current investment issues," said Solow. "However, the chief investment strategist makes the final decisions about whether or not we will make a change in our portfolio strategy. One drawback of a team is that it is easy to want to 'accommodate' the views of any individual team member, out of mutual respect and the desire to avoid team conflict."

## **Conclusion**

The diversity of investment committees operating in the RIA space almost certainly reflects their current novelty. It's a tool that was borrowed from relatively large organizations – endowments and trust companies – and we appear to be in the early stages of adapting it to smaller RIA practices. Also, while many trust companies look much the same in their investment approach and have embraced a more deliberate investment process, the RIA community is extremely varied and generally enjoys greater flexibility and quicker response time when opportunities or dangers arise.

Perhaps more importantly, the quiet adoption of investment committees throughout the RIA community could mean that the profession is reaching a new level of maturity. Going forward, RIA investment processes will be more professional, more informed, and perhaps more hungry for outside input and collaboration.

Meanwhile, advisors will want more guidance on how to use this new part of their practices. Plenty of questions remain unanswered. Does the investment committee improve investment performance? Is that even a goal? What are the drawbacks to making portfolio decisions by committee? Where does the investment committee get its information and ideas? Is there an ideal size for an investment committee? How often should it meet? Should its members take on specific roles, and, if so, which ones? Should investment decisions be depend on a consensus vote or should final responsibility fall to the investment committee chairperson?



In my survey, I asked these questions. Some of the responses, detailed in part two of this report, which will be published next week, may surprise you.

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