



Being Able to Answer the Question

By Tom Brakke, CFA*

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Advisors everywhere are sitting down with their clients. These meetings are happening in small-town living rooms like the ones where hard-working people once entrusted their life savings to my father; they are happening in gleaming skyscrapers, some newly renamed by bankruptcy or a takeover; they are happening in lavish wealth management offices, in exclusive enclaves of the very-rich; and they are happening at organizations big and small, with pension plans and endowments facing new uncertainties.

To these clients, I offer the following advice: Act like the child who keeps repeating one question over and over, and whenever your adviser makes a statement ask that simplest of questions.

“Why?”

I do not mean the angry “why” that attempts to find the politicians and CEOs we can blame for this mess, nor the cosmic “why” that wonders what kind of economic world would be better to live in, nor even the painful “why” (for all concerned) that asks how major losses might have been avoided. Each of those questions can be informative, but what’s done is done. Looking backward too much is counterproductive.

Instead, I am talking about challenging advisors on every element of what they believe about the future of the economy, the markets, and the investment business. When those fateful “why” questions are asked, advisors will need to be able to articulate their views and explain how they differ from others’.

Advisors, expect some emotional “whys” along the way, given that people often seek out advisors for the handholding that they get in return. Many clients are finding it harder now than ever before to believe reassurances to stay the course. Faith and trust have been lost, and they will need a reason to believe in your advice and counsel.

Related to that is the fee-related “why.” Some argue that the business of financial advice is overbuilt, and that the environment will be increasingly competitive, creating pressures to lower or eliminate fees. (Others say that individuals will realize how much they need help, which would have the opposite effect.) The proliferation of vehicles for investment, many of which feature lower fees than products advisors might be using, are also a negative pressure on fees



— the disparity in fees for similar products and services is amazing and is likely to narrow.

Which brings us to the active-management and relative-performance-measurement “whys.” Investors’ affinity for each has helped build the investment business as it exists today; the question is whether the focus on actively managing and measuring performance relatively helps or hurts, under what circumstances it does so, and whether that focus is worth the costs involved.

Of greatest interest are the analytical “whys” that support your decision-making processes. If you are putting variables into an asset-allocation model that determines your clients’ future performance, you’d better be able to explain why every one of them makes sense. You also need to be able to understand how the model works and under what conditions it breaks down, and you must consider whether the theoretical assumptions of all of the models you use truly reflect the likely behavior of market actors.

If you select investment managers, how much do you really know about their investment processes? Can you cut through the marketing spiel and their past performance to consider the probability that their work will match the needs of your clients? What will happen under different possible scenarios if they do what they say they’ll do? *Can* they do what they say they will?

The set of potential analytical questions is long and detailed, but it boils down to this: If the extent of your analytical effort is accepting conventional wisdom and using common tools, you will need to spend more time and money than you have in the past to be successful. That may mean adding staff with more research experience, purchasing different information services, or altering your decision-making processes.

Interwoven with all of these considerations are the belief “whys.” You have built your business on certain ways of doing things, preached a particular gospel of investment to your clients, and found some leading lights in the investment world who you like to quote and imitate. Why?

For every one of the questions I have asked, you must force yourself to look forward and to consider possible outcomes — good and bad, expected and unexpected — and how probable they are. You can deal most successfully with the uncertainties of the market by using methods, systems, and analyses that match its complexity with flexibility and robustness. Optimization models, style categorizations, performance rankings, and other key underpinnings of the advisory business alone won’t be enough. You should add capabilities that incorporate abnormal distributions and the lessons of behavioral finance. Above all, good investment decision-making requires a range of opinions and



information sources; make sure your process includes them.

To answer clients' drumbeat of "whys," I suggest you try it out yourself. You undoubtedly have platform vendors and money managers that you rely on. How do they answer the question when you throw it at them? Can they explain why their techniques make sense looking forward, just as you may need to?

This tumultuous time in the market has brought into question the business models of all types of financial firms, from the tiny to the gargantuan and from the basic to the supposedly sophisticated. For the health of your business, it is critical to examine your model and to make a compelling case for every element of it if you are to thrive. There are opportunities for those who innovate and differentiate themselves. And the best of those opportunities will be reserved for those who ask "why."

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