The Hidden Cost of Ignoring Evidence

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An advisor recently told me that he lost a large client to another firm. This advisor said he had carefully explained the benefits of evidence-based investing to the prospect and thought he had made a convincing case. The firm that got the business indicates on its website that its core competency is its ability “to select outperforming fund managers.”

The losing advisor was distraught and confused. He wanted to know if I could help him understand how the prospect could make such an “irrational” decision.

The evidence on fund manager selection

On the merits, this advisor was 100% correct. The data on the inability of fund managers to “beat the market” year after year is overwhelming.

Rick Ferri recently reviewed the June 2015 S&P Dow Jones Indices Versus Active (SPIVA) Persistence Scorecard and noted that only 5.28% of the 682 U.S. equity funds among the top quartile in March 2013 were able to maintain that distinction by the end of March 2015. He also observed the difficulty fund managers have remaining in the top half of funds, ranked by performance, for more than a few years.

Other studies, including a seminal study by Nobel laureate Eugene Fama and Kenneth French, have established conclusively that few actively managed funds produce benchmark-adjusted expected returns sufficient to cover their costs.

Despite vast resources, even the most sophisticated investors (like retirement plans, foundations and endowments) have a dismal track record in their attempts to select outperforming fund managers. One study looked at the fund selection and termination decisions of 3,400 plan sponsors between 1994 and 2003. It found that if plan sponsors “had stayed with fired investment managers, their excess returns would be no different from those actually delivered by newly hired managers.”

Why, then, are advisors who look for the next “hot fund manager” successful in persuading prospects
they have a skill that can’t be found in the academic literature?

**The evidence on evidence**

The distraught advisor who lost his prospect was proceeding on a commonly held, but flawed, assumption. He thought marshaling the evidence in a persuasive way would capture the business.

He would have been correct in his approach if decision-making were based solely on a careful, rational and objective review of the data. Unfortunately, it isn’t.

In *Thinking, Fast and Slow*, Daniel Kahneman demonstrated that we often make decisions quickly and intuitively (which he calls “thinking fast”) rather than in a more onerous, careful and analytical way (“thinking slow”). We like to think we engage in the more deliberative process, but in reality it’s more the exception than the rule.

Other studies support this view. By some estimates, emotions account for 80% of the decision-making process.

The advisor who called me spent 100% of his time conveying data to a prospect who likely made his decision based largely on emotions.

**The role of trust and other emotions**

Almost everyone would agree that establishing trust is critical to a successful relationship between an advisor and a prospect or client. There are many articles that provide useful tips on how to foster trust. Most of these tips are just common sense: Be sincere, professional and demonstrate integrity.

I have these additional recommendations:

- Initially, recognize that establishing trust (among other emotional connections) is more critical than proving your expertise or the merits of your offering.

- Add emotional content to your marketing materials. Almost every brochure I review is filled with data. But you need to tap into the emotional part of your prospect’s brain. You can do this by “humanizing” your materials to show who you are and to demonstrate your core values.

- Emotions you want to convey include trust, integrity and sincerity. Use “image advertising” aimed directly at evoking those feelings as an adjunct to your marketing materials. Even large corporations, like Walmart, have discovered that tapping into emotions is a savvy marketing strategy.

While there are many well-produced videos available for purchase that deal with the merits of investing, I couldn’t find any that dealt with the emotional side of the decision- making process. At the request of a coaching client, my creative team produced this one, which is the first of a series I will produce.
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