

# Tools of the Trade: Defining Your Role

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## **If you can't beat the market, what real value are you providing to your clients?**

As an advisor trying to build a successful practice, you have a limited amount of time each day to accomplish a seemingly unlimited number of tasks. Unfortunately, far too many advisors make the mistake of wasting that precious time trying to enhance their clients' returns above what the market offers.

The fact is, moving money around in the capital markets is one of the least productive ways for advisors to spend their time because it adds no value. The sooner we understand the true role of an advisor, the sooner we as a profession will be able to start creating real value for our clients—and our firms.

Clearly you need to give something of value to clients to build a successful practice. That's why so many advisors attempt to use "superior" knowledge, experience, or analytical ability to generate stronger returns for their clients through active management techniques. They believe that if they can find an analyst, a money manager, or some other expert who can tell them which stocks are undervalued—a "Tiger Woods of money management"—they will beat the market and their clients will love them. Sound familiar? Some of you even think that you're capable of doing the job yourself through in-house research efforts.

The question you need to ask yourself is this: Does all that effort making forecasts—or searching for someone who can—make a positive difference for your clients? One of my heroes, Vanguard founder John Bogle, sure doesn't think so. He and I participated in a recent panel discussion at an AICPA conference in Las Vegas. When one of the CPAs on the panel said he used brokerage firm research to help clients beat the market, I thought Bogle was going to jump out of his seat. Bogle's response: "The value of that research is zero, and that's not my personal opinion—that's a tautology."

Bogle nailed it—as did New York Attorney General Eliot Spitzer in a recent USA Today interview in which he argued that "if you begin with the presumption that picking stocks really is almost a fool's errand, and consequently, that paying someone else to do something he or she is going to fail at, then losing a significant percentage of your return to those fees is, consequently, a very unwise thing."

You simply cannot create value for your clients where the opportunity doesn't exist in the first place. One of my favorite examples of this comes from a July 2000 Fortune cover story that asked the top analyst in each market sector for his or her top pick. A year later, Fortune checked back and concluded: "Last year's All-Stars delivered as many strikeouts as home runs...Of the 28 stock picks, 11 are up and 17 are down." While the S&P 500 lost 9%, these analysts' picks sank almost twice as much, an average 17%. The headline on the original article? "Let Them Make You Rich." Several years later, many of those stocks' poor performances are even more pronounced.

This is just one example, of course, but it's the type of thing you'll see again and again if you're paying attention.

It's possible, I suppose, that some of you may be capable of consistently knowing when to be in and out of the market or of identifying winning stocks, and can beat the indexes time and again. If so, I congratulate you. You're extremely gifted and should keep doing exactly what you're doing. If not—and I know from speaking with hundreds of advisors each year that nearly all of you fall into this category—you're doing a disservice to your clients and it's time to stop.

## **Why Try?**

There's no doubting the overwhelming evidence that active management and research efforts fail to add value. In fact, the studies show that they subtract value. So I often wonder why so many advisors continue working at ways to uncover inefficiencies in the market that simply aren't there—especially when it's clear to me that most advisors believe the job cannot be done. For example, not one person challenged Bogle's statement at the conference. That's because they know in their guts that it's a futile task.

I think the problem for many advisors comes from a misperception that they need to move money around to give clients what they want. I've met plenty of advisors who recognize that they can't beat the market rate of return, but are convinced that their clients will desert them unless they go through the motions of selecting managers, picking individual stocks, deciding whether to overweight Japan or Europe, and so on.

These advisors essentially are trying to justify their fees by looking busy and working at something that they know creates nothing positive. But at the end of the day, they can honestly tell their clients about all the research they've done on the economy, the markets, companies, and managers. "My clients are happy and my fees are justified," they claim, "because of all my hard work."

In the other camp are those advisors who believe they can find ways to enhance returns in the future despite the fact that they've been unable to do so in the past. Hindsight is 20/20, of course. When we look back at market cycles, it seems obvious what we should have done. That causes these advisors to say they'll look for the obvious signs that tell them what to do next time. What they're really doing is feeding their egos. That gluttony wouldn't bother me if they did it with their own money, but they're doing it with capital that their clients are trusting them to manage responsibly—needlessly putting someone else's wealth at risk to pump up their own self worth. Eventually, after enough missteps, their clients will catch on and head out the door.

## **Know Your Role**

The good news is that you don't have to bury your nose in research reports or hunt down the savvy stockpicker du jour to keep clients happy. Instead, you can spend your time in ways that deliver real value to your clients—value that they'll recognize and appreciate and for which they'll gladly pay you.

The single greatest way to add value is to give your clients what I call a successful investment experience. That means more than getting them to their goals. It means that you help minimize or even eliminate the stress that they feel about the investment process, allowing them to stay focused on the long term and stop worrying about their money. If you do this for your clients, I promise you that the only complaint you'll ever hear from them is "I wish someone would have done this for me sooner."

Delivering a successful investment experience will require many of you to rethink your role. For example, your job is not to create wealth for your clients. No advisor in the history of this business has ever created wealth because wealth is not generated by moving money from stock to stock, sector to sector, or market to market. Wealth is created by the millions of entrepreneurs, executives, managers, laborers, and other workers who build companies, run companies, and together help make the economy grow. Your role in this process is to ensure that your clients benefit fully from that wealth creation. The only truly effective way to do that is to deploy their capital throughout the public equity markets in a broadly diversified manner designed to deliver the capital market rate of return.

A successful investment experience also requires that you focus on "doing right" by your clients at each and every step instead of trying to constantly enhance their returns. Here's an example of what I mean. When I was an advisor, I met a recently divorced woman with a stock portfolio worth around \$700,000. She was under a tremendous amount of stress because she had been out of the workplace since college and was living in absolute terror that she would be destitute if she lost her money in the financial markets. As a result, she was working with three different brokers and videotaping Wall Street Week trying to find someone who could tell her what the markets were going to do next. She also was an alcoholic.

When she became my client, I immediately put her entire portfolio in US Treasury bills and told her that her capital would be protected until she worked out her personal problems. By spending my time getting to know this woman and doing what was right for her instead of picking stocks, two things happened: She was able to get her life in order, and I had a happy and loyal client. Clearly, you can build a very successful business simply by doing the right thing on behalf of your clients.

Finally, your value as an advisor also comes from your ability to bring discipline to the investment process. If you can help your clients avoid making big mistakes like trying to time the market or rely on investment forecasts, you'll provide enormous benefits. I know many investors who had moved out of stocks by the beginning of 2003 due to the bearish environment and the prevailing gloomy outlook for the future, and weren't around to take full advantage of the equity market's spectacular performance last year. Now they all want to be back in the market, of course. Likewise, many advisors are tempted to make frequent and significant shifts in their clients' asset allocation—essentially treating rebalancing as another form of market timing.

As I explore these and other important issues in future columns, you'll come to realize a crucial lesson: If you keep investors—and yourself—from making mistakes like these, you will have no trouble building a successful investment advisory business.

In other words, if you do your job, the numbers will take care of themselves.

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