SEVEN DEADLY SINS OF INVESTMENT MANAGERS

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In this Halloween season, we'd like to reflect on some of the ghoulish behavior we've witnessed in the investment management industry. Here are some things that should raise the hair on the back of your neck if they come out of your advisor's mouth.

"Your performance is good"

Sounds like more of a treat than a trick, right? Performance should be discussed not in English class (vague words), but in math class (show me the numbers).

"You had a great year, and you're up 10%!"

I know what you're thinking- that's an actual number, so we're getting what we want. True, but that number alone is not necessarily enough to assess the skill of your advisor. If you own a portfolio of large cap stocks, and a good index that measures the performance of large cap stocks (like the S&P 500) is up 20%, being up 10% isn't great. It isn't good either- it's lousy. It's a good idea to ask your advisor for context.

"There's too much uncertainty in the market, so we're going to sit on the sidelines and sell your stocks"

First off, in over 100 years of managing investment portfolios, the one thing we have never, ever come across is certainty. In fact, with very few exceptions, the more "uncertainty" (another word for "fear") in the stock market, the more likely the opportunity for great returns going forward. Conversely, whenever investors feel fully confident in the infallibility of the stock market, it may be time to head for the hills.

"We put in stop-loss orders so we'll get out before we lose too much"

This one is absurd on two fronts; we'll address the first here since the second one is part of the next sin. Stop-loss orders (automatic orders to sell a stock when it falls to a certain price) may be ineffective if the stock falls rapidly- if nobody wants to buy at your price, you're unlikely to find a magical buyer that will take it off of your hands.

"We're going to go ahead and sell this one since it has dropped 10%"

We'll more or less stick with the Halloween metaphor here- if you buy a pound of chocolate for $1, and a day later it goes on sale for $0.50, do you

a) Call your chocolatier and demand that he sell all of your chocolate,

b) Buy more chocolate, as these prices may not last, or

c) Rest comfortably that chocolate prices vary, and have faith that chocolate will never go out of favor?

Whether they realize it or not, many investors and advisors routinely choose option A. We tend to prefer option B (in our humble view, you can never have enough chocolate), but option C is fine with us as well. After all, the only people who should probably sell the chocolate are those that did not take the time to really understand it in the first place.

"You need to be much more diversified"

This one can be close. If you have more than 10% of a portfolio in a particular security, or you have the bulk of your assets in one sector, you might be able to use some more diversification. That said, many advisors will put together portfolios of countless funds, each of which holds countless stocks. As we discussed in "Barbecue Ribs and Index Funds-Ah, There's The Rub", if you own everything and pay fees, you will by definition underperform the market by the amount of fees you are paying.

"I guarantee…"

This one is so bad it's against the law, but still seems to hang on. Other than death and taxes, there are no guarantees.

Try to remember that no advisor is an oracle—most do their best to adhere to a stringent strategy in which they have faith. But if your advisor utters any of these cringe-worthy statements, Benjamin Graham, the father of value investing, may roll over in his grave.

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