Drilling Down on the Competition

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Over the past few weeks we have observed a variety of advertisements for professional investment management services. While we have all caught on to the misdirection of back testing and overcoming the barrage of television and newspaper advertisements is difficult. These promotions have been designed to lure accounts in excess of $500,000 by attacking the use of annuities and mutual funds as unreliable investment options for long-term investors. Interested persons are given the opportunity to get a "free" booklet discussing the firm's opinion about these investments. The "lure" is claims about these investments and the curiosity of investors seeking a reason to avoid them. Of course, the firm gets the individual's address as a result of this inquiry and can have one of the firm's marketing representatives zero in on the prospect.

One assumption is that a personalized, individually managed portfolio could provide better results than these alternatives. For many of our institutional clients who offer professionally managed portfolios we think we should provide some additional insight into such marketing tactics that blanket the airwaves. One firm that professes individual management charges 1.5% for accounts over $500,000 and up to 1.75% for lesser amounts. The implication is that accounts are managed individually yet one firm that falls into this category has over 62 thousand clients and $94 billion dollars under management. Can an individual really get personal account attention in a firm of this size? Shouldn't we ask the question: "How many accounts are assigned to one portfolio manager?" And, "how often are accounts restructured to meet a changing market environment?" Or, "how much real investment management experience does each portfolio manager have and what is the turnover of account managers?" The real challenge will come in the next major market downturn. Investment advisors can move their clients to defensive portfolio positions, but the big firms are very unlikely to do that because they have too much money and can't be agile enough to prevent clients from experiencing a sizeable portion of the downturn.

Another concept we find questionable is rebalancing based on a rigid time frame or asset allocation. Many firms advertise that they systematically rebalance portfolios. Maybe monthly or even more frequently with some firms. We don't believe in systematic rebalancing because this process forces the sale of winners and the purchase of losers. We are proponents of active investment management. The reason is that skillful, active management has produced above-average investment results for clients over reasonable time periods. U.S. equities have outperformed all traditional asset classes when held over the long run. Moreover, after adjusting investment returns for taxes and inflation, investing in the stock market has been an important means of generating significant wealth.