A Case Study: Unrealistic Expectations

By
Ronald E. Copley, Phd, CFA

A client recently called, concerned about his account. He said I made no transactions over the last quarter and thought I was not paying attention (my clients give me a Power of Attorney to trade on their behalf). The call disturbed me on several levels. I tried to explain inaction did not mean inattention.

I didn't engage in new transactions because I was happy with our current holdings. My client continued to opine I should make trades even though the account was showing good growth. I found the logic strange. To begin with, he somehow thought I could create more returns without taking additional risks. He did not understand the risk/return relationship.

This gentleman works in an industry where he sees immediate results from his labor. He performs a task that leads to a product: tangible input, tangible output. That something could happen with no action is foreign to his thinking. He lives by the adage, "Don't just stand there—do something." He is a man of action!

His confusion over my inaction arose from not understanding how the stock market works. I explained it may be better sometimes to "just stand there, don't do anything." A most basic rule in the stock market: Patience is rewarded. Still, the gentleman continued to think he could make the market do what he wanted—that action generates results.

I further explained the market does not respond to the actions of any one investor, but reflects the actions of a multitude of investors from all over the world. If he were one of only a few investors in the market at any point in time, his actions would drive prices. That is not the case except for very unusual circumstances. I tried to explain the logic, but he blocked it.

I pointed out his conservative risk tolerance did not permit me to take high risk. A high-risk, short-term investment strategy may be appropriate for an aggressive investor, perhaps one who wants to day-trade with money he could afford to lose. But it is not appropriate for a retirement account.

We discussed the difference between a short-term and long-term strategy at the inception of our relationship and he seemed to understand it. Given his low-risk tolerance, he agreed a long-term investment approach was appropriate. He agreed when emotions were not rampant. Since, emotions crept into his mind and overcame his intellect—the kiss of death for an investment program.

The gentleman was convinced I should be able to detect the future course of the stock market based on current trends. "Wasn't it obvious," he asked, "that the market was at an all-time high and had nowhere to go but down?" I told him I possessed no crystal ball and neither did anyone else. I further explained the market is a complex informational matrix of cross currents coming from a diverse spectrum of investors whose intentions cannot be detected in advance.

Stock prices at any point in time reflect the collective view of an investing community regarding the market's true value—and that value is not too high nor is it too low. If current market prices were not correct, an investor could easily spot the mistake and make a killing by buying undervalued stocks and/or selling overvalued ones. Unfortunately, such a simple approach is not possible. If it were, we would all be filthy rich. Mispriced stocks can only be seen in hindsight, not with foresight.

All my efforts to explain the basics of how the market works failed. Although he was educated in his own field, he had several misguided ideas of how financial markets function and how I should manage his account. He somehow believed my inaction was costing him money. I stated we were not singing from the same songbook; it was in our mutual best interests for him to either manage his own account or find another adviser who possessed a divining rod.

Although extreme, the story is a clear example of a client having unrealistic expectations of his financial adviser. Actually, this is the only case I have ever encountered. Although the client signed off on in a written investment policy statement about his risk tolerance and my management style, he tossed it all out the window. The disconnect between us was too wide to overcome.

In investing, make sure to align expectations with reality. Quick movements in and out of the market contradict a long-term investment strategy designed for retirement planning. Emotions combined with a lack of knowledge can lead to unnecessary frustrations for both the client and adviser. Have comments? Reach out to Ron.copley@gmail.com. LOL

Ron Copley is a Registered Investment Adviser and principal of Copley Investment Management in Wilmington. Besides managing money for individuals, retirement plans, and foundations, he conducts business valuations for the legal community and teaches part-time at UNCW.