Sticking to a Plan: Why Investors Should Take Experience Over a Sales Pitch

By

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A few years ago, I had an experience with a client that reinforced two important lessons I wish to pass along to readers. Mr. X was employed with a good income, in his 40s, had two children, and wanted to invest for retirement. He completed a questionnaire to identify growth as his primary objective, with a risk rating of 7 on a scale from 0 (no risk) to 10 (high risk). I wrote an Investment Policy Statement (IPS) to reflect a strategy tilted toward growth stocks, with additional diversification from other asset classes, including bonds, energy and real estate. Mr. X signed off on the IPS, and I implemented the plan.

At the time the stock market was in the beginning stage of a correction. I discussed it with Mr. X and was careful to explain we should not panic. We had a solid plan and should stick with it during market turmoil. I further explained his time horizon was much longer than the length of a typical correction. His time to retirement was approximately 25 years and his life expectancy another 25 years beyond that. His total time horizon was approximately 50 years, while the typical stock market cycle, from trough to peak, lasts approximately five years. Given these metrics, Mr. X should be mentally prepared to see 10 complete cycles during his lifetime and not be alarmed when one occurs.

The power of my logic was strong. It was based on historical experience in the US, dating to the 1920s, as well as Mr. X's questionnaire that placed him above average risk. I felt good about the IPS strategy and believed Mr. X was committed to it for the long-term.
I was dead wrong!

Shortly after we implemented the plan, Mr. X called to question the viability of our plan. He complained about the stock market's continued retreatment. I reminded him of our initial conversation in which we discussed the issue, and explained again that, because we have a long-term time horizon, he should not be overly concerned. When we ended the conversation, I believed his anxiety was eased, and we would continue as planned.

It wasn't a week later when Mr. X called to say he was transferring the account. I was shocked. He explained he had talked to another adviser who assured him preventative market losses. I could hardly believe my ears. "How," I asked, "could another adviser do that? What magic dust could another adviser sprinkle on the account to cheat the market into generating growth, without taking required risk?" Mr. X could not give me a good answer, but was convinced it was possible. I wished him good luck.

One lesson I learned from my experience is some clients are highly susceptible to a sales pitch. The financial advisory industry has many reputable advisers who are careful not to promise something they cannot produce. Still, the industry has a few who say whatever it takes to gain business. The adviser Mr. X spoke to may have given him a sales pitch, or Mr. X may have heard what he wanted to hear, but what he heard was not what was actually said. Whatever happened, Mr. X's lack of education about how financial markets work caused him a problem.

I lost contact with Mr. X since our last conversation. I hope he is happy but have my doubts. I also learned from this experience something I already knew: to be very careful in managing client expectations. Even though I tried to warn Mr. X market corrections will occur, and he should be mentally prepared when they do, he either did not hear me or chose not to pay attention.

Upon returning home many years ago from Vietnam, where I had spent a year in combat, I clearly remember sitting on the plane taking off from Tan Son Nhut Air Base, and thinking humanity must find a better way of resolving differences than killing each other. My conclusion then and continues with me now is education offers at least a partial solution. Education increases the chance people will communicate more clearly with each other. War is dramatically more serious than investing, but the concept is the same in both instances.

Readers can email Ron Copley comments to ron.copley@gmail.com. LOL

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