Change…You Can Lead It, Follow It, Or Ignore It

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The other day I had lunch with an old friend who is a senior executive at a major brokerage firm. After catching up on our respective businesses and families, he mentioned that he was helping a financial advisor in his firm pursue an $80 million dollar account with an individual investor. He shared with me some of his concerns.

He said, "Dave, I've done so many presentations to investment committees for pensions and foundations I feel like I should be able tackle this presentation without a problem. But, if I a treat this presentation like a pension plan, I feel like I'll sound the same as all the other firms presenting to this account. We will all talk about the relationship between risk and return, asset allocation optimization, style allocations and manager selection. Quite frankly, for the high net worth investor, I'm not sure that any of this really applies to what their needs really are."

He is absolutely right. Those of you that have been using one of the wealth management diagnostics from Financeware know that asset allocation as it is generally practiced is interesting, but has little to do with meeting a client's financial goals. Asset allocation is focused around optimizing the return per unit of risk. The problem with an optimized return is a higher return often doesn't mean the client will have more money. We've written other papers about timing risk so I won't go into the details of how a much higher average return can end up millions short of the result from a lower average return (for more information read our white paper, The Asset Allocation Myth, found in the white paper section of "Support" on our website). The mathematical fact is that for any one investor's situation, *when* they receive high or low returns can be far more important than *how high their average return* is over the life of their financial goal package.

Intellectually, my friend understands these concepts. However, after years of training and presenting something that has "worked" (measured by closing business rather than necessarily meeting the client's goals), adapting habit and conventional wisdom to newly discovered facts can be very difficult. This has to do with being willing to adapt to change.

We all get wiser each day. We learn new things and the world changes around us. Look at the change the Internet has brought to us in such a short period of time. We really have only a few choices about how we deal with change. We can ignore or fight it, which are just opposite sides of the same coin, one merely being hostile and the other ignorant. Either way, ignoring change or fighting change has us sticking to what has worked for us in the past. Or, we can embrace change and lead the way by learning what we need to learn to make use of new knowledge. We can adapt our approach to maximize the value of what we have learned. Ignoring or fighting change has the same outcome…a future struggle to catch up to a world that has passed you by. Change is based on new knowledge and moves us forward. If you aren't moving forward you are moving backward. It was time for my friend to adapt to the future and he acknowledged it.

Adapting to this change can be difficult though. First, we have to be willing to let go of all of the tools and methods we focused on for so long. In my friend's case, this means freeing himself of the "Investment Objectives Questionnaire" that he used maybe three thousand times over the last decade. That questionnaire, designed to identify a tolerance of risk so he could create an asset allocation optimized for return and an investment policy statement with risk and return benchmarks, was rather useless based on his acceptance of new knowledge.

The brochure or "pitch book" that he used for so long, highlighted services that really were somewhat meaningless based on his new knowledge. Even the software he used at presentations to demonstrate the value of asset allocation and diversification now seemed somewhat misplaced.

If you've spent a decade trying to explain asset allocation, correlation and diversification, all of which are focused around the improvement of risk adjusted return, and you suddenly find out that it is all rather misguided, you are going to have to change. It is like discovering the world is round.New knowledge changes some really basic assumptions and the way you think. For example, you no longer need to worry about sailing off the edge of the earth.

In my friend's case, adapting to newly discovered mathematical fact meant that his ongoing "Progress Reviews" that measured returns, really weren't measuring progress at all. They were designed to measure risk-adjusted returns. There is an old management saying that you should "measure what matters." If risk-adjusted return doesn't matter, but that is at the core of the service you provide to clients, maybe you should begin to rethink your services.

So, in my friend's case, adapting to this new knowledge meant that he would have to change:

1) The presentation he made about his services

2) The fact finding methods he used to profile the client

3) The presentation of the solution he'd provide after fact finding

4) The ongoing monitoring services he provided to maintain the client relationship

This is obviously a massive undertaking and will take a lot of effort to redefine each step in the client relationship process. Knowing my friend though, I'm absolutely confident he will be able to adapt. If you've already made the changes to your practice to adapt to this new knowledge, please share it with us.

Watch for future papers highlighting how advisors have embraced this change. Perhaps together we will be able to define a new process where advisors can focus on measuring what matters and helping clients reach their financial goals.