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## How To Pick An Advisor – Plus Some Advice From Babylon



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### Key Points

- *To be financially successful, one should do three things.*
- *When identifying an advisor or money manager to work with, what are some qualities to look for?*

Recently, to mix up my son's book list when I read to him at night, I decided I should throw in a book on financial literacy. One classic in the field that I have had on one of our bookshelves at home for years (though admittedly never read before) was "The Richest Man in Babylon" by George Samuel Clason. It was written in 1926 and is basically a collection of parables set in ancient Babylon. Though the particular copy I own is musty and tattered (I bet I got a good price on it), and is also one of the older versions that was written in the language of the King James Version of the Bible, I decided to give it a shot.

It was a hit. My son liked the setting in ancient times, which is similar to many of the adventures we read together, and the basic financial lessons came across clearly. While the book had many chapters and multiple lists<sup>1</sup>, the lesson of the story boiled down to three key points.

For one to be financially successful, one has to:

- 1) Live on less than you earn (save at least 10% of income).
- 2) Make your money work for you.
- 3) Learn how to invest -- or hire somebody with the experience and integrity who knows how.

Let's talk a bit about these three keys.

### Savings Rates

Living on less than what one earns is the foundation to financial success. Yet, the personal savings rate (as a percentage of disposable income) in the U.S. was only 3.5% in 2009<sup>2</sup> – and that represented an improvement from prior years. In fact, in 2005, the savings rate was a mere 1.0%. For a frame of reference, during the 1960s through 1987, the savings rate in the U.S. was more like 9%. These days, apparently most people equate financial success with investing instead of the basic personal finance concepts such as budgeting.

## Make Your Money Work For You

The next tip is making your saved money work for you. Of course, this means after a safety net is first established. Items such as managing debt, building cash reserves, and buying insurance are critical to enabling an individual to take the necessary risks that accompany investing.

Are people making their money work for them? Well, looking at household debt levels, that does not appear to be the case for many. In 2009, household debt as a percentage of disposable income was 122%<sup>3</sup>. This is better than it was in 2007, when it was 131%. This compares, however, to the pre-1990 average of 80%. In short, when a person is in debt, they are actually letting their money work for someone else.

“Can you be an investor?” Investing is about taking risks. And how much risk one can take depends not only on their attitude toward risk, but also their capability to take on risk. If one hasn’t built an adequate safety net, it may become difficult to stay the course with a long-term investment plan.

## Investing

The third nugget of advice is to learn how to invest, or the importance of finding somebody with the experience who can either provide adequate advice or manage the investment, or both. Given that investing is not the full-time occupation of most people, it’s likely that many investors will want or need some level of advice.

Investing includes different opportunities, of course, as it can include entrepreneurial ventures, real estate investing, or public stock and bond markets’ securities. All have their pros and cons.

When it comes to building an investment portfolio of securities, should an investor self-manage or hire someone to manage their money? The key question begins with the investor. Do investors believe they have the temperament to manage their investments? Do they have the ability to stand pat with their investments (or buy more) when others are selling and vice versa? Are they able to remain disciplined if their style of investing is temporarily not working? Does the investor have the time and the tools in place for success? Successful investing is not just about raw intelligence. Like all successful ventures – it takes work.

If an investor feels he or she isn’t able to properly invest on his or her own, or if the investor just doesn’t want to, then finding an advisor makes sense. The hope is that an advisor will ultimately provide some level of convenience and peace of mind, and to do so, the advisor should provide a disciplined process and a steady hand during turbulent times. They should help identify an appropriate level of risk. And, can they generate, or help generate, a reasonable rate of return given that level of risk?

How does one find an advisor that can help accomplish some of those objectives? You do your homework. At Kobren Insight Management, we interview hundreds of mutual fund portfolio managers a year. Some of the questions we ask are exactly the same ones investors should be asking when they are shopping for an advisor or manager. To find an advisor that one can be comfortable with, consider asking some of the following questions:

- How long have they been in business? Firms that have been around in various economic and market cycles have the experience of diverse market conditions. They have a track record that can be examined.
- Do they have an understandable investment philosophy and process? Understanding the basic philosophy and the process of how the money is being managed is essential, particularly for staying the course during the more difficult market periods – which there always will be.
- How well do they communicate? Meeting a potential money manager face to face, or even by telephone, is important. Do you trust them? Respect them? Like them? Do they seem passionate? Competitive?

Reading what they've written is also critical to understanding the philosophy and the process and how it may be evolving. Do they have intellectual humility? Do they talk about what is not working – not just what is?

- Do they have a long-term orientation? If the money is being invested for long-term purposes, then one should expect that the advisor in question is indeed thinking long-term in his investment decision-making.
- Do they care about the prices paid for an investment? Personally, I like managers to care about how much they are paying for an investment. Some managers, however, simply like stories irrespective of price. I believe that beginning valuations are critical in determining future returns.
- Will they provide good service? A good advisor or manager will provide good service through thick and thin. Again, good information flow during the more difficult periods in the market will be important.
- How do you get paid? This is an important question to see if interests are aligned. For example, if the client does well, will the advisor do well? If a client's assets fall, will the advisor's revenues fall as well? On this point, when selecting an advisor, simply ask if they follow a fiduciary standard. Following a fiduciary standard means that the advisor must act with undivided loyalty to the client. This includes disclosure of how the Financial Advisor is to be compensated and any corresponding conflicts of interest. (For an RIA, this information can be found in the ADV Part II).

Learning about compensation incentives may also provide insights on the motivations behind investment decision-making. An example would be if a manager has performance incentives. If so, it would be important to consider and monitor the potential temptations to take on additional risks (or perhaps even alter their process) if they were behind on their performance targets.

These are some of the considerations that we take into account at Kobren Insight Management when picking a mutual fund portfolio manager. I believe they are also applicable when an individual investor picks an investment firm to manage their money.

## Next Research Perspective

Hiring an advisor is one difficult decision, but once you've hired one, how do you assess his or her performance? How do you decide if or when to sever the relationship? Stay tuned for a future article on this important topic.

Sincerely,



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Portfolio Manager

<sup>1</sup>An example of one list is the "The Five Laws of Gold:"

1 - Gold cometh gladly and in increasing quantity to any man who will put by not less than one-tenth of his earnings to create an estate for his future and that of his family.

2 - Gold laboreth diligently and contentedly for the wise owner who finds for it profitable employment, multiplying even as the flocks of the field.

3 - Gold clingeth to the protection of the cautious owner who invests it under the advice of men wise in its handling.

4 - Gold slippeth away from the man who invests it in businesses or purposes with which he is not familiar or which are not approved by those skilled in its keep.

5 - Gold flees the man who would force it to impossible earning or who followeth the alluring advice of tricksters and schemers or who trusts it to his own inexperience and romantic desires in investment.

<sup>2</sup>From H. Bradlee Perry's Marble Harbor June Ruminations, "The Hangover."

<sup>3</sup>From H. Bradlee Perry's Marble Harbor June Ruminations, "The Hangover."

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