Financial Fables

Ely Prudent Portfolios

Most of What is Done is Negative

GUERDON T. ELY, MBA, CFP®, AIFA®

January 2013

"Most of what we do is either neutral or negative. We prescribe the latest and greatest pill or procedure when, more often than not, what the patient needs is a better diet and more exercise." The comment, from a doctor friend, reminded me of my mother. Let me explain. My mom had some chronic health problems, but she lived to ninety-two and was mentally alert and relatively active the whole time. When I asked her about her secret to long life she said, "The doctors will tell you to do all of this and none of that. But in a few years they will give you a new list of do's and don'ts. What you should do is a little of everything and not too much of anything." And that's what she did. She only took medications that were absolute necessary, she ate a balanced diet and she walked every day.

The financial services industry needs to listen to my mom's advice, because very little of what is done is neutral and most of what is done negatively impacts returns. I first became aware of this from Mike Stolte, a former head of 3M's pension plan and a consultant to public employee retirement systems. In a 2001 National Association of Corporate Directors newsletter, he wrote that professional managers, "…spent many hours dutifully massaging the portfolios. They also made impressive presentations…But good intentions aside, their aggregate effect was to diminish the value of the pension funds."

In his new book, The Clash of the Cultures: Investment vs. Speculation, John Bogle informs us that things have changed for the worse since Stolte's article. "My primary purpose in writing this book is to sound the alarm about the shocking change in the culture of finance…the relentless rise…of speculation, characterized by…complex and exotic financial instruments, and trading in derivatives of various securities (rather than the securities themselves)." Unfortunately, most of the innovations to which he refers have better served Wall Street than the client. As Paul Volcker, former Federal Reserve Chairman, lamented, there have been only two positive innovations, in the last 40 years, "…that have served investors well…the index mutual fund…[and] the ATM."

That's it as far as adding value for investors: index funds and ATMs. So listen to Bogle and ignore all the claims of miracle financial cures. "The secret to investing is that there is no secret." The truth is that hedge funds, derivatives, structure products, variable annuities, and other complex products being prescribed by Wall Street are nothing more than expensive placeboes. And market timing, stock picking, rating services, and other forecasting tools are useless procedures. The prescription for financial health is a steady diet of index funds; a US index, an international index, and a bond index.

Bogle filled that prescription when he, in the words of Robert Frost, "…took the [road] less traveled..." by creating the first index mutual fund and "…that has made all the difference" for investors. It made investing simple but not easy. That's why Bogle's procedure is more important than his prescription. "As the financial markets swing back and forth, do your best to ignore the momentary cacophony, and to [remember]…the most important principle of all investment wisdom: Stay the course!"

In this uncertain world, I can't guarantee that Doctor Bogle's prescription and procedure will produce a healthy retirement account. Neither can I guarantee that a good diet and exercise will produce a long and healthy life. But are you willing to trust your financial health to a culture in which, according to Stolte, Bogle, and the statistical evidence, most of what is done is negative?

ELY PRUDENT PORTFOLIOS, LLC
10 DECLARATION DR., SUITE D
CHICO, CA 95973

(530) 895-0636 OR (800) 560-0636
WWW.ELYPORTFOLIOS.COM
GTELY@ELYPORTFOLIOS.COM