Financial Fables

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The Investment Answer

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“The answers are all true,” Mike whispered to Al. Mike and I were seventh graders in Mr. Wright’s first period health class and we had just finished an exam of true/false questions. We knew the answers were all true, because we had corrected the test in class. Mr. Wright sternly warned us against divulging this secret to the next class as we passed in the hallway, but Mike could not resist sharing such a valuable piece of information with his best friend, Al. However, to paraphrase the name of a TV show, Mr. Wright was smarter than a seventh grader, because he switched tests to one with all false answers. Needless to say, Al flunked the test.

Al flunked because Mike gave him the wrong answers. Investors are also failing because they too are listening to bad advice. Wall Street, the financial press, brokerage firms, insurance companies and mutual fund companies are all telling us they have the right answers to our financial questions. We listen to their whisperings because we are afraid. In the book, Freakonomics (written by a University of Chicago economist and New York Times columnist), the authors point out that we are afraid because investment risks seem out of our control. We listen to so-called experts, because they seem "exceedingly sure" of themselves and their advice. "Experts" know we are afraid, and they also know the best chance they have of getting our attention is to appeal to this fear, which "...as emotions go...is more potent than the rest."

Unfortunately, all this advice is not working. According to the most recent Dalbar study, the average stock fund investor earned significantly less than half the market return. The reason for this failure is that we are looking for short-term answers to a long-term problem (making our investments last for our lifetime). We focus on the short-term because, as Freakonomics notes, "Fear best thrives in the present tense. That is why experts rely on it, in a world that is increasingly impatient with long-term processes, fear is a potent short-term play."

So, where do we go to find the long-term answers we need? The answer to that question just got a whole lot easier with the recent publication of Gordon Murray's book, The Investment Answer. Gordon was a big time Wall Street investment banker who a decade ago had "...an epiphany about the futility..." of what he was doing. He realized that financial success doesn't come from stock picking or market timing or from finding the best mutual fund or hedge fund managers. It comes from making markets your ally instead of your adversary, by being patient and disciplined, and by having a long-term time horizon. The inspiration for the book was the result of a terminal cancer diagnosis. In his New York Times column, Ron Lieber noted that Mr. Murray's "...first impulse was to mourn...[but] instead he...channeled whatever energy he could muster into a slim paperback...to explain investing in a handful of simple steps."

The simple steps are five questions that, according to Gordon, if you get the answers right will "stack the investment odds in your favor...[because] you will no longer be a speculator [with short-term answers]...you will be an investors [with long-term answers]." The answers are: (1) Get unbiased advice, (2) allocate among stocks, bonds, and cash based on risk tolerance and liquidity needs, (3) diversify effectively, (4) use index funds, and (5) rebalance.

It is tempting to listen to the whispers of financial experts with their confident predictions, but in my humble opinion, it is as effective as listening to Mike. To keep from flunking retirement, you must resist fear and embrace common sense. You need The Investment Answer.

Ely Prudent Portfolios, LLC is a fee-only investment advisory service working with individuals in or near retirement and non-profits. The firm is accepting new clients with a minimum AUM of $1,000,000

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