The Expert Advisor vs. The Costly Facilitator:
Examining Advisory Relationships

The challenge faced by those seeking expert wealth management advice is that at the onset of a relationship, it is very difficult to tell whether someone holding themselves out as a financial services professional is, in fact, an *Expert Advisor* or simply a *Costly Facilitator*.

You can rest assured that the sign on the door of the aforementioned facilitator does not read:

John and Jane Doe's Investment House: We specialize in profiting from our wealth-crippling facilitation of the poor behavioral investment tendencies of our clients.

In fact, in a tribute to the art of obfuscation, it is more likely that it reads:

John and Jane Doe's Investment House: Trusted advisors for over 150 years for sophisticated investors.

We know that the burden of discovery rests solely on the shoulders of the client, so we thought we would take some time to write about that which differentiates an expert advisor from a facilitator.

With a watchful eye it is easy to spot the facilitators. Facilitators typically fail to have a clearly stated investment philosophy. They want the flexibility of being able to offer a prospective client or client whatever investment approach the facilitator thinks he or she wants. Invariably, facilitators offer several different investment solutions that are often philosophically inconsistent. As a result, they may have clients following conflicting strategies, which makes it impossible to send a consistent message to their clients.

Despite the trend of brokers adopting fee-based models, many are operating like old-fashioned commissioned brokers instead of client-focused expert advisors. A facilitator is happy filling trading orders, following clients' emotion-based instructions, and saying what clients want to hear. The behavior of a facilitator is a holdover from an archaic brokerage business model. We think it is a shameful representation of our profession, as we know facilitators are not serving the best interests of their clients.

Facilitators may even encourage a client to make decisions that might relieve anxiety in the short-term, but are damaging in the long term. A recent example is the 78% increase in fixed annuity sales in the first quarter of 2009, compared to sales in the same period in the previous year. Facilitators were allaying clients' fears by selling equities at fire-sale prices and locking clients into fixed-rate annuities at historically low interest rates. Is a fixed annuity with a 2% rate of return a good idea? Not only did those clients miss out on the recovery, but they will be saddled with huge surrender charges when they want to break the annuities after interest rates have reverted to their mean values.

A facilitator might allow these actions to take place out of fear of losing the client or simply to earn a commission by exploiting client fears. Facilitators generally do not impose discipline and rationale on the investment process because there typically exists no comprehensive wealth management plan, which is a significant part of the value of an advisor in the first place.

Unfortunately, facilitators often lack the skills needed to truly educate and advise their clients and must fall back on other means, such as persuasive sales skills or high-pressure marketing, to find and retain client relationships. They may not be willing to spend the time, or simply may not have the knowledge, to properly educate their clients.

In contrast, expert advisors are client advocates.

As an expert advisory firm, Rockwood Wealth Management has the confidence and courage of well-vetted conviction; we build rational portfolios and then maintain discipline, even in what seems like the worst of times. We have a clearly stated and sound philosophy about the integration of investments and financial planning. We educate our clients, set expectations, and work in a collaborative fashion to serve our clients' best interests.

An expert advisor is an educator who understands what his or her clients want to accomplish and defines and then implements a process to achieve their goals. Expert advisors carefully evaluate a client's situation and make recommendations that are in the best interests of the client, even if the client initially disagrees or initially wanted to take a different course of action. Expert advisors understand that the most prudent course of action is not always the easiest path. This is especially true considering the emotional highs and lows brought about by personal biases about markets and wealth.

As expert advisors, we have the flexibility to use any product or vehicle we feel is optimal, but we use those tools in a way that is consistent with our core beliefs. In the end, we possess the integrity required to avoid an approach we believe is not in the client's interest.

As you know, we are certain that education is critical to a successful advisor-client relationship. We hope you've benefited from our writings related to behavioral finance, determinants of portfolio performance, how capital markets work, and the financial services industry in general. In our experience, clients make the best decisions when they are both well educated and comfortable communicating openly with their advisor.

You can take solace knowing that no facilitation takes place in our firm—as we are focused squarely on your most deeply held goals.

They took the risk, but didn't stick around for the return.

At Rockwood Wealth Management, we assert that the *delivery of a great client investment experience* requires:

(a) The utilization of efficient investment vehicles (low cost, diversified, risk specific, and tax efficient), and

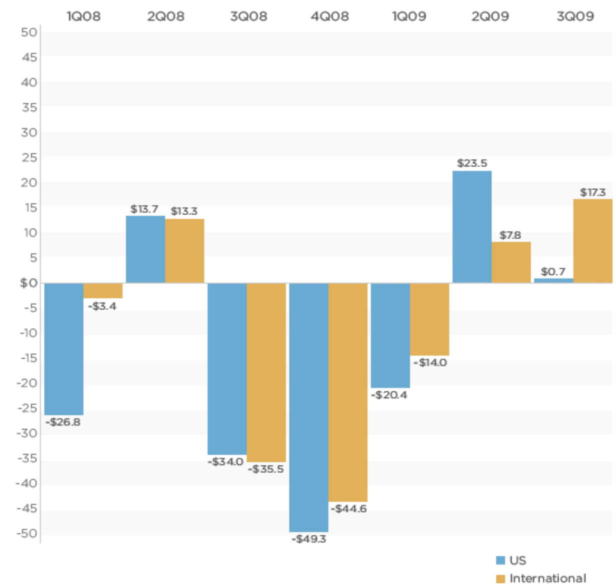
(b) The guidance of a professional advisor.

The period of 2008–2009 provided us with a striking example of the difference between advisor-directed cash flows and retail cash flows (those with poor or nonexistent professional advice). We sought to examine who pulled money out of the market in panic and who participated fully in the recovery so far in 2009.

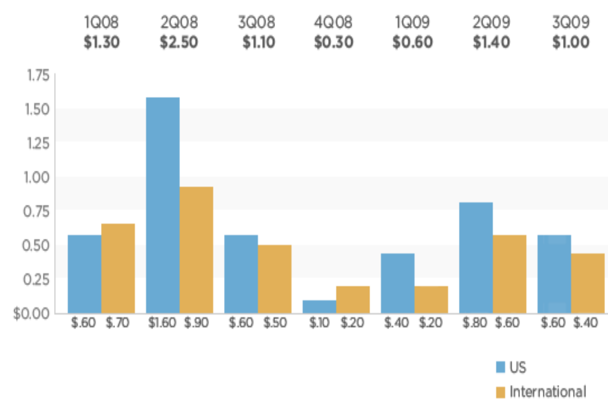
Although not an exact measurement, industry-wide cash flows give us a good sense of the retail investor experience. Examining cash flows into Dimensional Fund Advisors' institutional funds gives us a good sense of the advisor-directed client experience, as those funds are not offered in a retail channel. What did we see?

Frankly, we saw exactly what we expected to see—and generally what happens with each major market oscillation. Industry cash flows were volatile and driven by emotion (namely fear and greed). Retail investors yanked money out of the market hand over fist at precisely the worst time. On the other hand, cash flows to Dimensional Funds (the tools we typically use to implement strategic investment plans) were consistent and driven by an advisor's rational view of the capital markets. The following graphs will certainly help to illustrate this point:

Estimated Industry Cash Inflows and Outflows of Stocks Mutual Funds (in Billions USD) Jan 2008–Sept 2009



Advisor-Allocated Cash Inflows to Dimensional Equity Funds (in Billions USD) Jan 2008–Sept 2009



Source: Morningstar Estimated Net Flows Open End mutual funds and funds of funds.

You'll note that industry cash flows to equities started out mildly positive in 2008 and then became increasingly negative through the end of the first quarter of 2009. In contrast, advisor cash flows to Dimensional equity funds stayed positive through every quarter of the period. Also, the allocation to domestic and international stocks stayed remarkably consistent through the period. Clearly, as a group, properly advised investors like you were not selling in panic, but rather following a consistent, long-term perspective as you deployed your capital in the market.

When the equity markets turned around in February and March of this year, you were "in your seat" to capture the dramatic returns over the following months. As you know, these are the types of periods that drive long-term rates of return. Unfortunately, the individual retail investor's experience was most likely just the opposite. It appears many retail investors were sitting on the sidelines as the equity markets came back to life in February and March of 2009. In a sad state of affairs, the ill-advised retail investor **seems to have an unshakable habit of taking the risk but not sticking around for the return.**

As we all know, controlling emotions is probably one of the most crucial, but least recognized, parts of our relationship with you. Studies by Dalbar, Morningstar, and others have all documented the retail investor's lack of discipline and corresponding inability to capture the long-term capital market rates of return. We spend considerable time enhancing our ability to be a steady, rational, guiding hand to help you navigate through the emotions associated with investing in the capital markets en route to your financial goals.

Congratulations to you for exercising discipline during an immensely difficult time in the global equity markets. We hope you feel that you have been very well served.

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