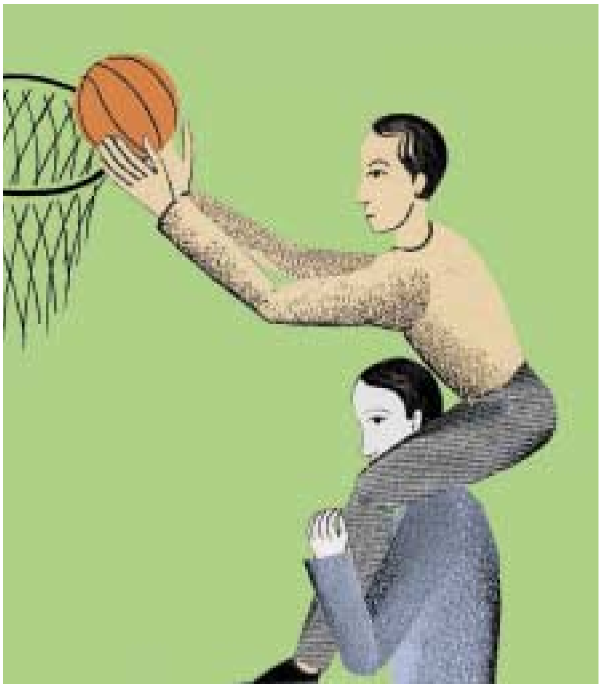
Game Time

Clients who've learned some investment skills are no longer content on the sidelines. Are you ready to make them part of the team?

Mary Rowland



JUST TWO YEARS AGO, WHEN the stock market was still producing millionaires as fast as McDonald's makes burgers, many advisers were losing clients. Things got so bad by the end of 1999 that one prominent planner told me his firm was "hemorrhaging assets." Now that the market is in turmoil, nervous investors have come scurrying back to advisers. Clients, as you know, are as fickle as the markets.

Of course, choosing investments is the least important thing you do for your clients. But clients don't know that. They're far more likely to focus on portfolio performance. That's what brings them in and ensures their loyalty. It's also what's most likely to make them turn away.

That's why advisers need to be reminded that the recent tech boom and bust has changed the thinking of investors all across the country. They've learned something—maybe just a smidgen—about stocks, and they're making some choices of their own. They're not going to give that up. Blame it on the Internet. Blame it on the trillions of dollars they've put into 401(k) plans. Whatever caused it—it's something you've got to live with. Many of your clients want to be players now. They're not going to be happy with the Anonymous Index Fund. I know because that's what happened to me.

To understand what's been going on, let's separate investors into two groups: In the first are the investment professionals, and here I include financial advisers. The rest of us land in the second group. For you, investing is a science, something done by parsing asset classes and cranking up optimizers. For us hoi polloi, investing can be a psychological issue. Advisers often recognize this; some call it behavioral finance. They know that people hate to lose money. But I'm not sure they recognize that many clients want to participate in the market.

As we reported in May, that was one of the discoveries Roger Gibson, a Pittsburgh money manager and author of *Asset Allocation: Balancing Financial Risk* (McGraw-Hill), made during the tech bull market. Gibson, too, lost clients and wanted to figure out why. He saw that it was because those clients were not keeping pace with their friends who invested in tech stocks. So he decided to tell clients that if they used an asset-allocation approach to investing, they would have more money in the long run, although, he explained, they would often win when their friends lost and lose when their friends won. One client—clearly an honest one—told Gibson he'd rather make less and stay in sync with his friends.

Illustrations by Ivetta Fedorova

I talk to investors. I see how much they've learned. They're not going to be happy with an optimized portfolio and a bunch of nameless index funds

Not every client is as shortsighted as this one. Some of them—most likely the engineers, accountants, and actuaries—are perfectly happy with an optimized portfolio. They understand why it makes sense to include asset classes that are negatively correlated; they buy into it and they sit tight. But lots of others don't get it. They feel a vague uneasiness. Their friends own Qualcomm and Nokia. They hear all these people talking on cell phones on the train and in restaurants. They want to own the stocks.

If I hadn't developed a personal stake in the investments I own, I'd probably put all my money in the Vanguard Star Fund and leave it there for the next 30 years. That's the strategy I suggest for people who can't afford a financial adviser. Star nicely approximates a diversified portfolio set up by an adviser. The fund invests in a number of other Vanguard stock and bond funds. Since its inception in 1985, it's turned in an average annual return of 12.46 percent. Last year it earned about 11 percent.

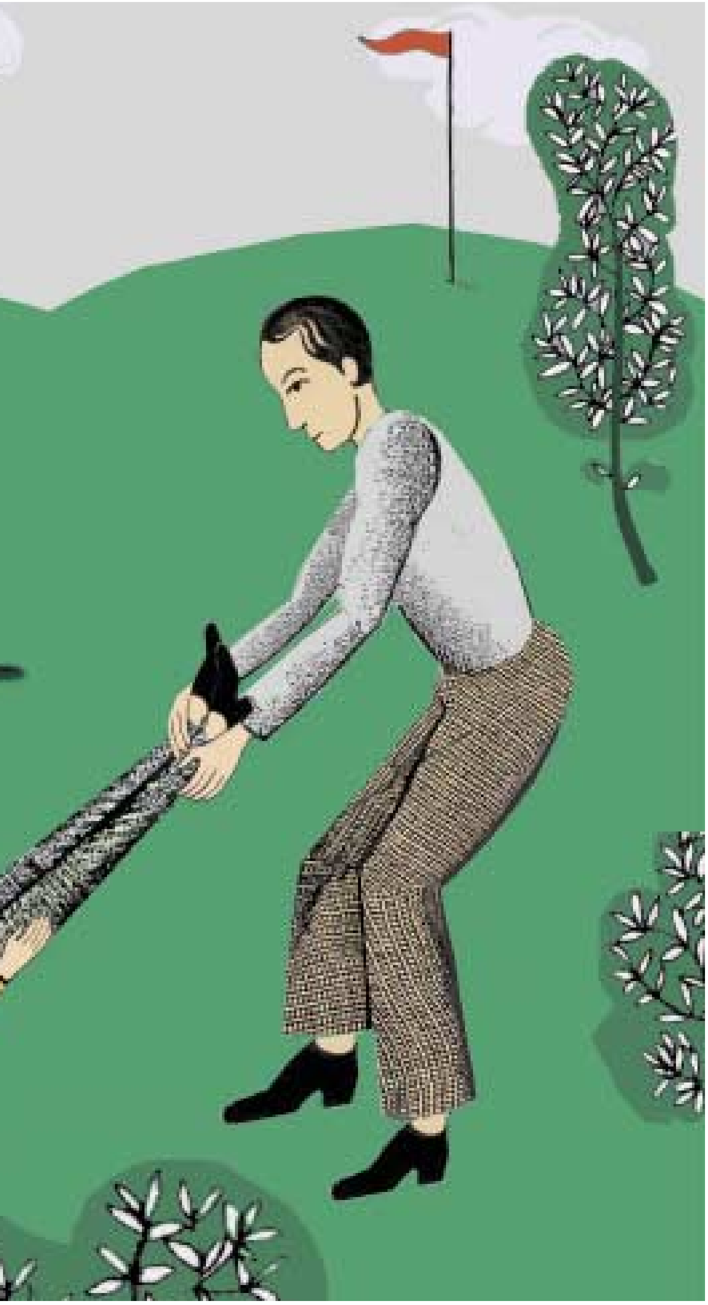
But I don't want to invest in Star. Nor am I interested in the DFA index funds or any of the other humdrum choices. Like many of your clients, I want to be a player. And because the course of my evolution as an investor was probably much the same as many of your clients, I'll share it with you—embarrassing as it is. I've been a business journalist for 25 years. For most of them, I preached the mutual fund buy-and-hold philosophy, much as Jonathan Clements does in his "Getting Going" column in *The Wall Street Journal* on Tuesdays.

Three years ago—about the time many Americans began to invest on-line and chat about it—I began writing a weekly investing column on MSN MoneyCentral. I was reluctant at first to write the column. What could I—girl reporter and conservative investor—offer to compete with columnists such as Jim Jubak blithely picking the 50 best stocks in the world and Jon Markman using his computer to generate super models that had annual gains in the neighborhood of 600 percent? The answer was disheartening. Still, I plunged ahead. I suggested to my editor that we call my column "The Fuddy-Duddy Investor," thinking it might appeal to the cautious. This failed to excite. We settled on "The Careful Investor," and I began to write about the virtues of buy and hold, the best value funds, and the like.

But not for long. Readers want columnists to have opinions and express them. My editor urged me to show investors how to set up stock screens and watch portfolios, how to identify stocks they might want to buy, and then collect information on the companies, including analysts' reports and breaking news.

He also asked me to write about what I had in my portfolio and why. Fair enough, except here's what I had in my portfolio: Dodge & Cox Stock, Mutual Shares, Mutual Discovery, Oakmark Small Cap, SoGen International (now SoGen Global), Templeton Developing Markets, Third Avenue Value, and Third Avenue Small-Cap Value funds, and Intel Corp. I didn't want to talk about it. I'd always preferred value to growth because I felt that value was something you could hang your hat on. I loved Henry Emerson's *Outstanding Investor Digest,* with its interviews with Warren Buffett and Bill Ruane, chairman of the board for Sequoia Fund, and the boys at Tweedy, Browne Co. I liked lead manager John Gunn at Dodge & Cox Stock, which had long been my largest holding. I loved Michael Price, chairman of Franklin Mutual Advisers.

Needless to say, I didn't write about my portfolio. But I researched stocks and wrote about them. I set up a screen that identified stocks with various characteristics including those trading 30 percent off their 52-week high with a low debt-to-equity ratio and 20 percent annual returns over a five-year period. From the list, I picked seven and before I knew what was happening, my editor posted them as



Uniphase. In the next year, the value of my portfolio more than tripled. It almost quadrupled. Then in March 2000, I moved two-thirds of it into cash because the growth felt like too much too fast. At the end of 2000, I bought some diversifiers—Wal-Mart, Home Depot, Exxon Mobil, Sony, Charles Schwab—and in April of 2001, I bought more tech stocks: Applied Materials, RF Micro Devices, Sycamore Networks, Nortel Networks, Nokia, Corning, and AOL Time Warner. Whenever the Nasdaq-100 Trust went below 40, I bought some. I bought White Oak Growth Stock when it went below 40 and Black Oak Emerging Technology for just over 5.

I made some good decisions. And I made some big mistakes. My biggest was growing overconfident. Smaller blunders included buying Lucent Technologies and Nortel and Sycamore and watching them sink beneath the waves. I also bought a fund called Open Fund because I liked the manager and I wanted to own some small biotech stocks but didn't think I knew enough to identify them on my own. Good enough. But Open Fund, which posts trades on-line, belongs in the category I called gimmicky funds back in my fuddy-duddy days. Some things don't change. I should have done more research and looked in particular at the fine Dresdner funds.

The point I'm making is that I've evolved as an investor over the past two years in much the same way as many other Americans did. Some no doubt did better than I; some may have been ruined. But I talk with investors every day in the MoneyCentral "Start Investing" newsgroups, and I see how much they've learned and what kinds of investments they're looking for.

Like me, most of them want to be players. They're not going to put all their money in the Star Fund or the Vanguard Total Stock Market Index. And they're not going to be happy with an optimized portfolio that includes a bunch of nameless index funds. Advisers must recognize this if they want to hold on to their clients.

Many advisers are experimenting with ways to satisfy clients now that the investment landscape has changed. In February I wrote a column about Ram Kolluri, an adviser in Princeton, N.J., and his notion that the best way to build an investment portfolio was to use a large-cap index as a core and then put together a group of stocks from the best companies in the world, buying them when the price was right. I got some resounding raspberries for that column. I still love Kolluri's idea because it's a way of solving the problem of how to make the client a player—before he finds another team.

"Mary's Watch Portfolio," with real-time quotes. I can't remember what was on it except for Qualcomm and maybe Texas Instruments. But I do remember that the stocks shot the lights out, all except for Robert Half International. That's when everyone wanted to know what secrets I was keeping in my own portfolio.

I was cornered. Finally, at the end of 1998, I wrote a column about the revamping of my portfolio. I sold off my value funds except Dodge & Cox. I bought Qualcomm, Cisco Systems, Microsoft, TranSwitch, Vitesse Semiconductor, Japan Webs, Fidelity Select Energy Service Portfolio, Longleaf Partners, and JDS Fitel, which merged with

Mary Rowland is the author of Best Practices for Financial Advisors *(Bloomberg Press). She speaks regularly to financial advisers on issues of practice management.*