How Bay Street Can Bridge Its Credibility Gap

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Bay Street, we have a problem. A PR problem. Our clients think we can do more than we're capable of. Some think we know which stocks are going up and when to get in and out of the market. We're setting them up for disappointment and as a consequence, hindering the growth and stability of our business.

The gulf between client expectations and the realities of the wealth management industry covers a lot of ground. Investment returns are at its core – what's hoped for versus what's achievable – but there are other factors that serve to widen it.

Overselling

We all want to win new clients, so naturally we put our best foot forward. We trot out all the great things we've done in the past. Savvy stock picks and prescient interest rate calls are duly highlighted. We advertise the funds that are performing the best right now.

We do it because it works. Managers and advisers with the most appealing "recent past" look the smartest and win most of the business. Industry statistics consistently show that money flows into funds and firms with good short- and medium-term returns.

But what makes it worse is that we continue overselling, even after the client has been won. We take credit for too much. Way too much. If a stock does well, it was a great call. If it goes down, it was a problem with the market. Our clients are led to believe that we have a higher batting average than we actually do.

Predicting the unpredictable

In overselling our abilities, we imply there's a level of precision in investing that just isn't there. When we confidently predict the market will be "up 8 to 10 per cent this year" or "the dollar has little downside from here," we weaken our client relationships. Too many factors come into play in a stock, currency or asset mix decision to project anything more precise than a range of potential outcomes. Sorting out the visible, quantifiable variables is hard enough; let alone factoring in the lesser-known triggers that lurk in the shadows. (How many prognosticators had Greece or Egypt in their forecasting models?)

Charlie Munger, Warren Buffett's trusty sidekick, refers to it as physics envy, or the tendency for economists (in this case, investment professionals) to put false precision into a complex system. "[The profession's] search for precision in physics-like formulas is almost always wrong."

It's a perverse world

But the gulf is not all our fault. The nature of investing makes it extremely hard to communicate clearly with clients. Capital markets are volatile, unreasonable at times and most often counterintuitive. Think about it. If everyone you know is recommending an appliance or car, then it's likely to be a good buy. If, on the other hand, they all like a stock, it's time to run for the hills.

In the perverse world of investing, it's hard to remain credible with clients when we're telling them their best moves will be the ones that make them feel the most uncomfortable. Or poor short-term results will translate into higher returns going forward. Or they should ignore a heavily

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advertised fund and buy more of the boring one in their portfolio.

In spite of these challenges, there are things we can do to solve our PR problem.

Narrowing the gap

When returns are really good, we can do a better job of talking them down. My former partner, Bob Hager, was a master of this. When he had great numbers to report, he went out of his way to point out the missteps he'd made. He primed his pension clients for a time when the numbers wouldn't be so good.

We can talk with certainty about uncertainty. It's not a matter of "if" an equity fund goes down 20 per cent, but rather "when." By framing it in these terms, expectations are more realistic and clients better prepared.

We can cast risk in a more positive light. After all, it's the fuel that drives returns and we're the risk managers. So rather than advertising our risk-free approach to investing, we should illuminate the risks our clients are taking.

And finally, we can represent the markets for what they are – totally and utterly perverse.

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