How To Get Out Alive – Part 4

Show Me the Money!

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Welcome to our continuing series on How To Get Out of Dentistry Alive, at least financially. The October DE article focused on "How Much" you need to be financially independent. In December I discussed "How To Get There", with a focus on Doctor at Work and Money at Work. February's topic was "Winning the Loser's Game", arguing that "active" investing is not in your best interest.

After helping dentists over 30 years, I am fully aware that many – and probably most – of you feel out of your element when thinking about business and financial matters. After all, you signed up to be a healthcare provider, not a business leader. I can live with that, and I have many very successful clients in that same boat. (See my article, "But What If I am Not A Business Person" in DE, March, 2003.) Every financial advisor has to cope with that reality, similar to the ongoing battle you endure to get your patients to floss!

So, what to do? For most of you, regardless of whether you are a Saver or a Spender, or a neophyte or a wizard in financial/business matters, you need to have knowledgable advisors. But you have to know enough, or at least have an inkling, to know if your advisors are serving you properly. A superficial knowledge is not sufficient, and certainly relying on their bedside manner, club or church affiliation, fancy office or slick marketing won't cut it. Unfortunately, even "reputation" may not be reliable, because you don't know how qualified your buddies are to have a critical opinion.

Remember, to a lay person, all dentists are pretty much alike clinically. You know better, of course; but keep in mind that you may fall into the same trap and think that all *other* professionals are basically alike, whether they are accountants, lawyers, financial advisors, etc. Believe me, there are "butchers" in every profession – and you are not qualified to spot them. They can either be incompetent, dishonest or both. But they will surely be "nice", or they could not stay in business!

Imagine how you would tell a patient moving to a new town to choose a good dentist. There is no fool proof way, assuming you don't personally know someone to recommend. Same dilemma in your quest for good advisors. "Asking around", checking credentials and references, and listening for reputable names to keep popping up are about the best you can do. And of course checking your own instincts and ability to communicate with a candidate are important. My point is that these are "necessary" conditions, but they may not be "sufficient". But you've got to start somewhere, and that's the best you've got for now.

However, in the financial advisory area, specifically, you DO have a simple tool to monitor your advisor's performance, and that is a Performance Report. If you are paying someone a fee or commissions to handle your money, they should give you such a report at least annually, if not quarterly. This report will show you how well your investments have performed over the past 1, 3 and 5 years, if not more. However, it should also tell you how your performance compares with recognized bench marks, so you have a basis for comparison. And you have to compare apples to apples regarding your stated risk tolerance level.

Don't let your eyes roll back into your head yet – this is fairly simple. You CAN understand this, so let me explain. (Once you have the background I will give you below, ask your advisor to explain your specific performance report to you. Use this as a test to see if your advisor is shooting straight with you – and to see if they seem to understand what they are telling you!)

First of all, I am NOT referring to the monthly report you get from your custodian or brokerage firm (Schwab, Merrill Lynch, etc.). That is more like a monthly bank statement. It tells you the current value of you account, what assets you hold and what buy/sell activity has happened that month. Instead, I am referring to a report that is typically a separate report that specifically refers to "performance" over a period of time. What rate of return your investments have achieved. This does not include growth that has simply been the result of your adding

more money. (I had an actual case in April where a dentist showed me a letter from his advisor that said the dentist's return was about 8%. It turns out that 10% of the account "growth" was new money added by the dentist, and that the investment performance was -2%! I think it was Mark Twain who said, "There are three kinds of liars: liars, damned liars and statisticians", so watch out!)

I am astounded by the number of dentists who have substantial accounts (i.e., over $100,000) who have *never* received such a report. At that level, you should *demand* such a report. Any respectable advisor should be pleased to provide that. In fact, it should be a huge red flag if you have to ask for it in the first place.

What if you are told your account was up 10% last year, should you be happy? The fact is, you can't tell in a vacuum. You might be pleased – until you hear that all your friends were up 20%! You need to know your performance "compared to what". There are at least two factors that affect the comparison: asset classes and risk. (Hang in there, this is NOT going to be difficult.)

If your advisor tries to get away with simply telling you that you "beat the market" last year and so you should be happy, demand an explanation. First of all, he should explain what he means by "the market". If he says that he is referring to the S&P 500, then either he is stupid – or he thinks that you are. Although the S&P 500 is familiar because it is tracked on the evening news, that is essentially a list of the 500 largest companies compiled by Standard and Poors. That would represent the "asset class" of Large Growth stocks, but it certainly does not represent the 8,000+ other public companies.

To make matters worse, the S&P 500 calculation is a weighted average, based on a company's size. So the 50 largest companies comprise about 60% of the calculated index. So if a company the size of GE sneezes, it is said that the rest of the S&P 500 catches cold. This is hardly "the market". In addition the S&P 500 has not performed well in the last 5 years, at least not until then last quarter of 2006. So ***everybody*** "beat" the S&P 500 during that time, or at least they should have. But that's like bragging about beating a 90-pound weakling.

Instead, if your advisor is properly practicing "asset allocation", you should have some stocks/funds invested in other asset classes, like Small Growth, Large and Small Value, International, etc. Each of those asset classes has their own benchmark, and those are what your performance should be compared to.

Then you have to know how much risk the advisor took to get his investment returns. If all your funds were invested in "risk free" government bonds and gave you a return of 10% (unlikely!), that would be preferable to getting 10% return with investments in risky company stocks. You should expect a lot more return in exchange for taking more risk. I met with a dentist last week who was pleased with his 8% return for 2006, especially since he thought he was primarily invested in bonds and CDs. When I showed him that his advisor had him fully invested in stocks and that such a mix returned about 21% for some other portfolios I had seen, he was not as happy as he had been. He had been exposed to the risk but had not gotten the reward.

A responsible advisor should help you determine your "risk tolerance" profile. He may call it by another name. (We ask our clients to choose between whether they want to "sleep well" now or "eat well" later. You can have varying degrees, but you can't have both.) You should write down your decision so you can both refer back to it. You can change it at any time; but meanwhile it gives your advisor some direction as to how to invest your funds. We call this your Investment Policy Statement, but it can go by other names.

One last thing: your relationship with your advisor should entail much more than simply investment returns. His job is also to provide guidance, discipline and advice. Do *not* get caught up in the trap of "shopping for returns" and continually switching advisors. Use the performance information as one of your tools to evaluate your advisor. Give him a couple of years to prove himself too. If he is consistently getting close to the averages of the appropriate indexes, then you are probably already beating about 93% of all your buddies – and you are on your way to winning the loser's game!