The Case against Multiple Investment Advisers

An oft-quoted maxim is, "*Don't put all your eggs in one basket*." While this is generally prudent advice and supports investment diversification, some investors believe it's wise to have more than one investment consultant. This article discusses the downside of adopting a multi-adviser approach.

Let's start by relating an actual case of a former Resource Consulting Group (RCG) client who retired about twenty years ago. At that time, he received a distribution from his employer's pension plan and rolled his large seven-figure amount into an IRA. He divided the money equally between four different "advisers." One was RCG; another was a regional bank; the third, a stock broker at a major firm; and the fourth, an adviser who used the investments of the Frank Russell organization. The retiree's plan was to give each adviser a year to "*earn their keep*." All parties were provided the same mandate in terms of asset allocation. After the first year, the client would take the money away from the two underperformers and award it to the top two performers. After the second year, he would take the money away from the underperformer and award all the assets to the top performer. Sound logical?

Unfortunately, here's what transpired: After year one, the client ended the relationship with the bank and the stock broker. Subsequently, the Russell adviser and RCG each managed half of the money. After year two, the Russell adviser ended up with all the money. At that time, the only significant difference between Russell and RCG was that RCG's account included REITs for full diversification, while the Russell account did not. During the year in question, REITs underperformed U.S. and foreign equities. Fast forward a few more years, and the client fired Russell for underperformance and moved all the money to The Vanguard Group to manage himself. This story didn't have a happy ending because the client did not have the "stomach" to stick to his carefully crafted asset allocation during the bursting of the tech bubble from 2000-2002. Instead, the client attempted to time the market; something a professional investment adviser would have prevented him from doing. There's more to this story than just an unhappy ending, though - there's some false logic that needs to be explored.

Does it really make sense to set up a "horse race" where the winner ends up with all the money? No, it does not. Here's why: Assuming that each adviser selected was a "low-cost manager of globally diversified investments", each one – given an appropriate time period – could have earned his or her keep. However, because of nuances in asset allocation, the short-term results of "like-minded managers" can lag each another, but these differences would even out over time. Ironically, by taking money away from the underperformers and awarding it to the outperformers, the client is systematically "selling low and buying high," the opposite of what we know to be a prudent strategy.

In this case, the assumption that each adviser was a "low cost, globally diversified manager" was not valid. Both the regional bank and the stock broker had highly concentrated stock portfolios and they were certainly not low-cost. In this sense, they deserved to lose the account. All that being said, even a flawed approach toward investing can outperform a sensible approach in any given year. So, is one year's worth of performance data an accurate picture of the sustainability of any investment strategy? We don't believe so.

In addition, utilizing multiple advisors surely results in higher overall management fees. Virtually all investment managers have tiered fee schedules where larger accounts are subject to lower fees as a percentage of assets under management. Controlling costs in investing is the only *guaranteed way* to enhance investment returns.

So what should an investor do? We recommend selecting a single adviser who follows a scientific approach to investing by employing Modern Portfolio Theory utilizing passive investments in a low management fee environment. This approach combined with good asset allocation advice and disciplined rebalancing is a recipe for long-term success. This is exactly what we've been doing at RCG for the last 23 years.

Nobel Prize laureate Daniel Kahneman probably said it best, "All of us would be better investors if we just made fewer decisions." Those words are especially prophetic in this situation.

301 East Pine Street | Suite 300 | PO Box 4930 | Orlando, FL 32802-4930
(407) 422-0252 | (800) 448-0252 | Fax (407) 649-8795 | **resourceconsulting.com**