

## Outside the Flags

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### The Freedom of Not Knowing



[Jim Parker](#), Regional Director, DFA Australia Limited



David Swanwick

What sort of investor takes comfort from their advisor telling them that they have no idea what is going to happen next in financial markets?

Like a priest suffering a crisis of faith, David Swanwick worried about leaving his valued clients feeling rudderless when he was making the transition to a passive investment philosophy.

But several years after embracing the change, Swanwick has discovered that letting go of the pretence of market omnipotence has actually strengthened his relationship with his clients and improved his business.

"Look, I've found the greatest synaptic block in adopting this approach lies with the advisor, not the client," he says.

"The client is completely ready to hear the person to whom they are entrusting their capital say: 'Would it surprise you that I can't predict where the markets are heading—tomorrow, next week, next month or next year?' They are ready to hear that message simply because it is just so sensible."

It might be a sensible message, but it is not always an easy one for advisors themselves to embrace. In his early years at Ellwood Barry McPherson, a Brisbane-based financial planning and investment firm, Swanwick and his colleagues would spend days trawling up and down the country looking for active managers to recommend.

On one such road trip, Swanwick was flown down to Sydney and wined and dined by a manager keen to leave him with the impression that its investment team had a better record than most at picking stocks and timing markets.

As it turned out, EBM decided not to recommend the firm. And that should have been the end of it. Except that Swanwick later heard on the industry grapevine that the spurned manager had accused him of being ungrateful for the hospitality bestowed on him.

"What's wrong with him? We took him out to dinner! That's what they were

saying," Swanwick remembers now. "I have to say it was the single most offensive thing said about our business—the idea that we would recommend a manager to our clients based on someone picking up the bill for dinner."

These days, having made the transition to passive asset class investing, the four advisors at EBM spend far less time researching managers and far more time sitting down with their clients to help them reach their individual goals.

"We don't buy into stories anymore. We're not interested in gurus," Swanwick says. "We don't lose sleep worrying about an investment team at a firm we've recommended pulling up stumps and moving elsewhere.

"And if anything, we're more profitable now than we were then. That's because we're focusing on the things that matter and delivering a better all-around service, which allows us to charge a higher fee."

Swanwick says EBM's success is also built on having a clearly documented investment philosophy—expressed in a 20-page manifesto—and a team of partners that all sing from the same song sheet.

He sees this document as providing the firm with a clear commercial advantage over other advisory groups, who have either stuck with trying to pick active managers or only half-heartedly adopted a passive approach.

"If you asked some other firms what their investment philosophy is, chances are they would look at you as if you came from another planet, because they really haven't thought about it properly or they have no consensus among their advisors," he says. "And even if they have, they probably couldn't articulate it in half an hour. So what you often see elsewhere is a document that while canvassing a myriad of investment options, fails to express any underlying belief about how markets work."

This is not to suggest that the transition was an easy one for EBM. The firm undertook a rigorous research effort before embracing the change to ensure the passive philosophy made sense from both a theoretical and applied level.

"We were initially quite sceptical," Swanwick says. "We went blow-by-blow through every element of the philosophy, asset class by asset class. After a process lasting 18 months to two years, we ran out of questions. And we were then comfortable enough, having invested our own money in this approach, to move to the approach in full."

Like many other advisors who have successfully made the transition, EBM places a high value on education and reinforcing to clients the benefits of taking a consistent, unified approach to capturing known dimensions of risk.

Some clients get it right away. Others take longer to click. But whatever the individual response, Swanwick has found that reinforcing the importance of discipline and keeping the client focused on the things they can control—like tax,

costs and diversification—pays dividends in the long term.

"Providing you've applied the strategy sensibly and remind them that you're not picking stocks, just capturing compensated risk, they will accept periods of negative returns. The greatest sense of comfort clients can get is from seeing that you have already thought about the issues they are raising."

Another issue clients bring up frequently in the early stages is how the firm justifies its fee now that it is no longer picking managers or timing markets.

"We deal with this by reinforcing the message in early meetings that there will be less activity in their portfolio and that this is part of a deliberate strategy to minimise turnover and costs," Swanwick says.

"Most importantly, we remind them that by giving them exposure to asset classes in a way that gets rid of avoidable risks, and that by being freed of having to make predictions about markets and finding the next best manager, we can concentrate on understanding their family situation better and planning for the next generation.

"The fact is people will not feel the need to question fees when they feel that their advisor understands them and their family, has a keen sense of their goals and wants, has their full trust and implements their investment plan in exactly the way they said they would.

"We've found that it's almost impossible to have a bad relationship with a client if you set those expectations and act on those expectations in a transparent way."

David Swanwick has discovered the paradox at the heart of all successful financial advisory businesses. By throwing away the crystal ball, by giving up on forecasting, he can see things more clearly. And in doing so, he can help his clients in ways he wasn't able to manage before.

Call it the freedom of not knowing.