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Advisors Need to Rein in Do-It-Yourself Investors

By Brian O'Connell

Financial advisors need, from time to time, to rein in clients who attempt a "do-it-yourself" investment approach, often with lousy results.

After all, someone has to save the earnest, yet misguided, DIY portfolio manager who most likely will walk away from the experience poorer and not necessarily wiser.

Americans who make their own investment decisions seriously underperform stock market benchmarks, and have done so for decades, a 2016 study by Dalbar concluded.

DIY investors looking for someone to blame for those negative outcomes should look into the mirror, Dalbar said. They tend to make “poor investment” choices, and are most often driven by emotion when making key investment decisions, the study noted.

The study results speak for themselves:

• In 2016, the average equity mutual fund investor underperformed the S&P 500 by a margin of -4.7 percent. “While the broader market made gains of 11.96 percent, the average equity investor earned only 7.26 percent,” Dalbar found.
• In 2016, the average fixed income mutual fund investor underperformed the Bloomberg Barclays Aggregate Bond Index by a margin of -1.42 percent.
• In 2016, the 20-year annualized S&P return was 7.68 percent, while the 20-year annualized return for the solo investor was only 4.79 percent.

Going solo as one’s own portfolio manager is not only a problem to the DIY investor, it’s a problem to any investment advisor who seeks to keep a client’s hands off the steering wheel when it comes to portfolio management.

“The do-it-yourself investor is one of the biggest challenges I face,” said James Barnash, a financial advisor at SGL Financial in Buffalo Grove, Ill. “With the second longest bull market in history running currently, a lot of people believe they can manage their own investments.

“What will they do when the eventual bear market hits? Most will panic and sell out at the worst time, the bottom.”

'They May Have Been Burned'

Vanguard and Morningstar have also done studies showing an advisor can add up to 3 percent on the total return of a person’s portfolio because of knowledge on diversification, taxes and just plain hand holding through challenging events, Barnash added.

Until there is a challenging event that costs them a lot of money, the DIY investor won’t completely trust an advisor, he said.

“They may have been burned in the past and figure why pay someone else to lose my money for me,” he said. “Building trust and confidence is a big key to getting them to give the advisor a chance.

“Don’t go for the entire pie, so to speak, but just get them to give you a slice to start with and work your way from there,” he advised other financial professionals.

The relationship between a DIY investor and a frustrated advisor often goes even deeper than that.

“Do-it-yourself investors are a problem to any financial planner because these investors are unknowingly undoing the precise advisory work that they paid their financial advisor for,” said Ryan Repko, a money manager with Ruedi Wealth Management, in Champaign, Ill.

Most do-it-yourself investors incorrectly believe that they have the inside track on the next big stock, or on some “less familiar” investment, he said.

“Many do-it-yourself investors are successful in their own careers, and they believe that they can carry over their job-specific expertise into managing their own portfolio,” Repko said.

Although some people are capable of independently managing their own portfolio, most don’t receive the returns they should because they sold their positions during low markets, he added.

“One of the single greatest services a financial advisor can provide to their clients is counseling them to stay invested in their positions, even when it seems like everyone else around them is selling,” he said. “A financial plan that is goal-driven has already taken into account the inevitably of market declines. By staying invested, one increases their probability of meeting that goal.”

Market Correction Looming?

That alone should give investors incentive to work with their advisors, especially given the growing consensus that the stock market is primed for a setback.

“Robert Thaler, the godfather of Behavioral Finance, has spoken to the fact that most people think they are more rational than they really are,” said Nick Sloane, president of Sloane Wealth Management in Warrenville, Ill.

It’s not so much about what an advisor can tell the client, it is what the client believes, Sloane added.

“Hindsight bias, which relates to a sense that past events were predictable, leads to overconfidence,” he explained. “Optimism bias - only bad things happen to other people - is another.”

People's short-term memory regarding things like the 2008 crash can also affect current decision making.

“In a sense, advisors are like therapists,” Sloane said. “We have to take a Socratic questioning approach to our client interactions. Meaning you want to have the client tell you what you want to tell them. Often, this is not easy.”

Sloane works primarily with people who are nearing retirement age. “I ask them how they would feel if early in retirement another crash occurred, as they are no longer depending on their human capital to pay the bills,” he said. “I don't just ask this rhetorically. I try to let this sink in and show the impact of a poor sequence of returns.”

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