The 9 Reasons to Have a Financial Advisor

Physician-investors tend to underperform without professional investment advice.

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Why an Objective View Matters

There are multiple layers to the question: do I need an investment advisor? Although there are no easy answers for everyone and every situation, for most, data show individuals do better using investment services versus going it alone. Theoretically, no one has a greater interest than the investor in protecting and looking after investments. However, a personal interest may be the single greatest factor working against individual investment performance. Most are risk-averse and biased, making it easy to put too much credence into noise, trends, and herd mentality.

Many investors, including neurologists, are affected by basic human emotions—getting overly optimistic and wanting in on the action when the market goes up, assuming it will continue to do so, or becoming extremely pessimistic during downturns and wanting to get out, fearing they may lose everything. In 2010, the Securities and Exchange Commission Office of Investor Education and Advocacy asked the United States Library of Congress Federal Research Division to prepare a report on the behavioral traits of US retail investors. The report identifies 9 common investing mistakes that affect investment performance. Often, these mistakes are made because of investors' emotional involvement in decisions.

The 9 Most Common Mistakes

Active Trading

Active traders buy and sell in response to monitoring investment pricing, hoping to time activity advantageously. Active traders underperform because constant activity and speculative behavior hurt long-term performance. A good advisor will assist you in creating a long-term strategic plan that does not involve churning—activity for the sake of activity.

Disposition Effect

Retail investors tend to hold losing investments too long and sell winning investments too soon. Most people are risk-averse—even more so when handling their own investments. Loss-averse investors tend to sell high-performing investments in hopes of offsetting losses from losing investments.

Prioritizing Mutual Fund Past Returns Over Fees

Many investors focus on past performance of mutual funds while virtually ignoring transaction costs, expense ratios, and fees, all of which can have significant negative effects if not accounted for. A good advisor will include these fees in any portfolio analysis. It is not only fund performance that matters, but ultimately the value received by the investor.

Familiarity Bias

Investors tend to gravitate toward familiar opportunities, which can lead to investing too heavily in glamor stocks and companies, local stocks, or an employer's stock. A good advisor will work to ensure investors are not overly concentrated in any area, keeping portfolios diversified to limit exposure.

Mania/Panic

Mania is the sudden increase in value of an investment receiving publicity as people rush to get in on the action. Panic is the inverse, when everyone tries to abandon a sinking ship. What is the next "bubble"? When will there be another "crash"? With the advent of 24-hour financial news channels, social media, and other sources of constant financial information, investors are now, more than ever, susceptible to mania and panic. All the noise leads to the next common factor.

Noise Trading

Noise trading occurs when investors act before conducting fundamental analysis, following headlines, false signals, and short-term volatility. Long-term planning requires choosing investments via qualitative and quantitative analyses. Advisors take emotional reactions out of the equation to build a plan to weather ups and downs.

Momentum Investing

Buying securities with recent high returns and selling securities with low recent returns makes the assumption that past trends and performance will continue. Chasing momentum in this way leads to speculative bubbles with inflated prices, often recognized last by retail investors. Momentum investing can cause an individual to buy high and sell low—with obvious detrimental effects on their portfolios.

Under-Diversification

Investors can easily become too heavily concentrated in a specific investment type, increasing their exposure with too many eggs in one basket. Long-term investment planning requires diversification and most investors need an advisor's assistance to diversify correctly without suffering the next common error.

Naïve Diversification

Diversifying equally among a number of investments rather than in strategic proportions is a common error. Proper diversification is not simply putting a number of asset classes into equal percentages but rather requires weighting investments in a risk-to-benefit manner that aligns with the individual's risk tolerance and long-term goals.

The Evidence for Using an Advisor

Data show that retail investors make the same mistakes repeatedly, buying when prices are high and selling once they have fallen. According to the 2017 release of Dalbar's Quantitative Analysis of Investor Behavior, the average equity mutual fund investor underperformed the S&P 500 by a margin of 4.70%. The market gained 11.96% but the average equity investor earned only 7.26%. In 2016, the 20-year annualized S&P 500 return was 7.68%, while the 20-year annualized return for the average equity investor was only 4.79%, an annualized gap of 2.89%.

Conclusion

An advisor's role is not just to pick the best stock or mutual fund, forecast economic conditions, and make tactical portfolio decisions. Those are all important components, as is acting as a buffer, putting space between you and your investments to take some emotion out of decisions. The bottom line is that emotions about money affect decisions. Savings represent security, stability, and goals attained. It's more than wealth—it's your future. With all of this on the line, it is virtually impossible to make consistently rational investment decisions over the course of a lifetime.

The best advisors work with their physician-clients to create strategic, properly-diversified, and long-term investment plans tailored to the client's personal risk tolerance and goals, while trying to minimize fees, costs, and tax-drag. An investment advisor's assistance will not remove all risk from investing in securities markets—nothing will. However, a strong advisor can protect against emotions, myopia, and fixation on short-term results. ■

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