HOPE SPRINGS ETERNAL

What baseball can teach us about investment expectations.

By Timothy G. Parker, CFA

As Spring Training begins in the world of baseball, fans of all teams are excited about the months ahead, when their team starts a new year with a fresh opportunity to have a winning season and emerge victorious from the World Series. The baseball manager that wins 55% of the time with players who hit 30% of the time is considered a hero, even a legend. Why are there much higher expectations of investment managers?

Like a baseball manager, investment managers cannot predict the future. Though both might give you their hopes and gut feelings, their predictive abilities are wan. A good manager does know how to win. Actually, they know what needs to be done to win and then focus on doing that very well. In baseball, managers look for the right player skills and attitude to fill a void on the team. Investment managers look for values and other attributes to fill a void in the diversified portfolio.

Managers who are good at finding these golden nuggets can be confident that things will eventually work out for their benefit. The baseball manager should have a better team that should win more games than he loses and the investment manager should have a portfolio with more winners than losers. Both share the same goal of beating their competition – a focus on relative return, not absolute return. When your stock market investments were down 35% in 2008 compared to the S&P 500 down 37%, were you pleased or upset? Over time good managers survive and bad ones fade away.

Would a baseball fan really have an expectation that the team manager will win every game? In the same vein how can a client have the expectation that the investment manager will always pick investments that appreciate in value? The public has a responsibility to not expect accurate predictions. Like their expectations for their weather forecaster, they should look to the expert to do a better job than they could do on their own, but not expect 100% accuracy over something nobody can control.

Investment professionals also need to move away from trying to predict the market. This is not an effort to lower the bar for the industry, but rather raise the bar. The reality is nobody can accurately predict market movements or have predictable performance year after year. If someone says they can, perhaps they just came *out* of a bar or should be *behind bars*. Not only do investment professionals need to move away from making predictions, but move people toward the value added that is more predictable such as non-investment planning issues and matching client goals and risk tolerance to asset allocation.

Asset allocation came into greater focus in 1983 with Gary Brinson's watershed work concluding that is where value is added. Security selection (picking better performing securities than the benchmark) pales in comparison. This was proved again in 2008 as there were huge differences in stock and bond market returns. In a 50% stock / 50% bond portfolio, lots of value was added simply by having 50% in bonds. Stock selection might add a few percentage points to the stock performance, but it was vastly outweighed by the asset allocation decision to invest a portion in bonds.

The biggest component of time an investment professional spends with a new or existing client should be asking questions and listening, trying to gather definitive information and clues that will lead them to the optimal asset allocation for that client given the client's goals, risk tolerance and financial situation. I tell prospective clients that, while my track record does show superior stock selection versus a benchmark, it doesn't really matter if they shouldn't be in stocks in the first place. That is the much bigger question, and one too quickly brushed over by investment managers and clients alike at the expense of the more "exciting" discussions of "predicting" the future of the markets. Let's see if we can all raise our batting averages this spring.

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