TAM Asset Management Review

Facts & figures on global investment strategies

November, 1993
No. 5

Do Clients Matter?

Investment Policy: How to Win the Loser's Game, by Charles D. Ellis (Part 2 of 14)

You will not learn how to invest by reading this book, but you can learn in less than one hundred pages how to be a successful investor— and to know you have designed a program of investing that will, almost inevitably, provide the results that are best for you and your purposes and is feasible within the realistic limits of the capital markets.

Every client of TAM Asset Management receives a copy of Charles D. Ellis' book *Investment Policy*. This book is by far the most useful, objective, and contemporary source on prudent investment strategy I have seen in fifteen years of studying the subject. It is also less than 100 pages long and very easy to read.

Mr. Ellis is managing partner of Greenwich Associates, the leading consulting firm specializing in financial services worldwide. The author of six books and dozens of articles, he has taught courses at both Yale and Harvard. Ellis earned his B.A. at Yale, an M.B.A. (with distinction) at Harvard and the Ph.D. at New York University.

Reprinted from *Investment Policy, 2nd Edition*, by Charles Ellis with the permission of Irwin Professional Publishing. For ordering information, call 1-800-634-3966.

Jeff Troutner, TAM Asset Management

In this sense, after you read this book, you will know and understand all you will ever need to know and understand to be a truly successful investor. For such a small book, this ambition may seem far too bold. But there is a countervailing modesty.

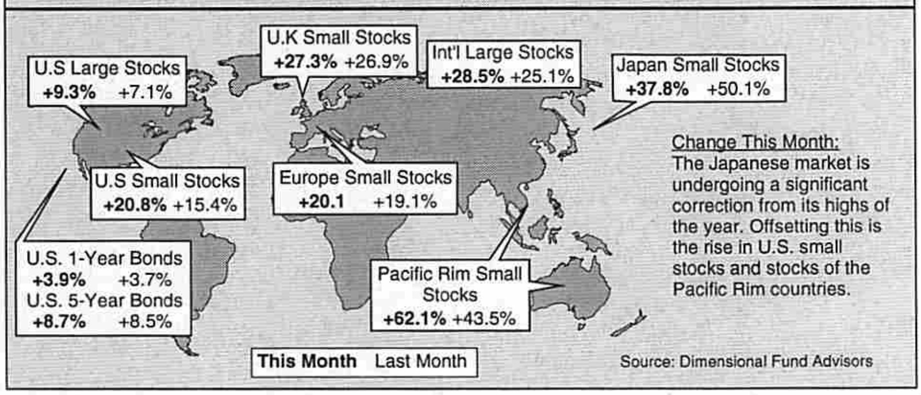
This book does not intend to explain how to be successful at traditional investment management—how to pick stocks, time markets, or execute major strategic shifts in a portfolio. Such a treatise would certainly require far greater length. It would be written for professional investment managers as producers and sellers of investment services. And it would be based on the assumption that it is feasible to outperform other investors in the active-aggressive kind of investment management that dominates institutional investing today. This basic assumption must now be in question[1]—only because so many talented, informed, experienced, and diligent professionals are working so hard at institutional investing that they make it unrealistic for any one manager to outperform these other professionals.

This book is different. Far from accepting the conventional wisdom that talented, competitive, professional investment managers can beat the market, it questions closely the whole concept of institutional investing as it is practiced today.

This book is not written for the sellers of investment management services. It is written for the buyers who, as clients of professional investment managers, have a real responsibility to themselves to understand the basic nature of institutional investing, why investment managers succeed or fail, and what can be done to achieve long-term investment success, even when their professional investment managers are failing to beat the market.

Continued on back...

Asset Class Returns Year-to-Date: 10/29/93



[1] Twenty-five years ago when I was writing *Institutional Investing* (also published by BUSINESS ONE IRWIN) it made sense to prescribe and advocate a strategic approach to active management. Today, the world of investment management is different, and the time has come for a different concept of the problem of investing and an appropriately different concept of the solution.

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Investment Policy (cont.)

This consumers' guide to investment management is designed to meet the needs of the many individual investors who entrust their family savings to mutual funds, trust companies, and investment advisors; the needs of the corporate executives and union and public officials responsible for pension funds; and the needs of the men and women who serve as trustees of the endowments of universities, museums, schools, hospitals, and foundations.

This book is written with a clear point of view: clients of investment managers all too often delegate or more accurately abdicate to their investment managers responsibilities which they can and should keep for themselves. Their undelegatable responsibilities are: setting explicit investment policies consistent with their objectives, defining long-range objectives appropriate to their particular fund, and managing their managers to ensure that their policies are being followed.

This book is a guide for those who will accept this central client responsibility and who want to be active, responsible, and successful, whether as fiduciaries or for their own account.

Much as it might seem obvious that client investors should care a lot about the way their money is managed, the reality is they typically do almost nothing about it—until it's too late.

Despite the fact that everybody "knows" that each family fortune or pension fund or endowment fund differs in situation from every other fund (and that these differences are often quite substantial), and despite the conventional consensus that these substantial differences should be reflected in different investment policies and practices, the plain fact is that the investment portfolios of most funds are very much alike.

This is not the way it should be. The needs and purposes of the funds are not the same, and their investment portfolios should not be the same.

Regression to the mean is a powerful phenomenon in physics and sociology—and in investments.

Without clear direction from their clients, it is natural for investment managers to move toward the center, to put portfolios in neutral, to be conventional. (It is also easier to treat all clients the same.) In other words, investment managers will tend to produce average portfolios for all their clients rather than portfolios that are carefully designed to meet the particular objectives of each individual client.

At the same time, ironically, professional investment managers lament over and over again that they feel they must compromise their investment decisions because clients do not do their part. In particular, managers believe they could achieve far better results if their clients took a longer-term view of the investment process and if their clients would only be more specific about the kind of investment portfolio they really want.

Clients "own" the central responsibility for formulating and assuring implementation of long-term investment policy. As has been suggested and will be shown, this responsibility cannot be delegated to investment managers. Fortunately, this client responsibility can be fulfilled without extensive experience in securities analysis or portfolio management.

To fulfill their responsibilities to themselves, clients need three characteristics: (1) a genuine interest in developing an understanding of their own true interests and objectives, (2) an appreciation of the fundamental nature of capital markets and investments, and (3) the discipline to work out the basic policies that will, over time, succeed in achieving their realistic investment objectives. That's what this book is about.

Investment managers will also find this book useful in providing a context for the work to which they devote so much of their time and skill—the day-to-day management of investment portfolios. Managers should encourage their clients to use this book as a guide to performing the vital role of being informed, active, and successful clients.

While it is a spirited critique of contemporary practice in institutional investing, this book is by no means a condemnation of investment managers. The problem is not that professional managers lack skill or diligence. Quite the opposite. The problem with trying to beat the market is that professional investors are so talented, so numerous, and so dedicated to their work that as a group they make it very difficult for any one of their number to do significantly better than the others, particularly in the long run.

There are two different kinds of problems in trying to beat the market. One problem is that it is so very difficult to do—and so easy, while trying to do better, to do worse. The other problem with targeting on beating the market as a primary investment objective is that this focus diverts the attention of both the investment manager and the client from the need to establish long-range objectives and investment policies that are well matched to the particular needs of the individual client. The real purpose of investment management is not to "beat the market," but to do what is really right for a particular client. And making sure the manager concentrates on achieving that objective is the responsibility of the client.

Does the client matter? Indeed he should. But the client will only matter if he asserts his authority and fulfills his responsibility: deciding investment objectives, developing sound investment policies, and holding portfolio managers accountable for implementing long-term investment policy in daily portfolio operations.