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Modern asset class investing principles, research, and perspectives for long-term investors

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Chaos, Order, and Consciousness

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Treat yourself like someone you are responsible for helping.

This is the title of the second chapter, or second rule, in Jordan Peterson's new book, "12 Rules for Life." Peterson is the Canadian academic and clinical psychologist who has been in the news lately as a result of an interview with a journalist that went viral. All the attention has been on his defense of free speech, particularly in the area of mandated use of preferred transgender pronouns, so you can imagine the controversy surrounding him in the current social and political environment. But he is first and foremost a clinical psychologist, and his experience and knowledge in this regard are what the book is about.

The main theme of Peterson's Rule 2 is that people tend to help other people more than they help themselves, and that this is neither good for the individual nor good for society at large. If I were going through a personal crisis or battling an addiction like alcoholism, his words and the way he presented them would be very powerful and probably transformational. But all I could think about as I read his words was how much they apply to our relationships with clients.

Peterson starts out by describing research that shows how poorly patients adhere to prescription drug regimens. Then he writes:

Physicians and pharmacists tend to blame such patients for their noncompliance, inaction and error. You can lead a horse to water, they reason. Psychologists tend to take a dim view of such judgments. We are trained to assume that the failure of patients to follow professional advice is the fault of the practitioner, not the patient. We believe the health-care provider has a responsibility to profer [sic] advice that will be followed, offer interventions that will be respected, plan with the patient or client until the desired result is achieved, and follow up to ensure that everything is going correctly.

I believe it's perfectly understandable for physicians and pharmacists to feel that way. They simply do not have the time or the training to do otherwise and therefore *must* rely on a patient's sense of personal responsibility to carry out the advice and plan that was presented to him or her. Physicians and pharmacists are trained to know the *science,* apply it to a certain set of circumstances, and essentially move on to the next case. This is how some advisory businesses are essentially run. They place the greatest emphasis on volume, or "asset gathering," rather than striving to optimize each client experience over a long period of time. This lack of optimization is also what any rational investor should expect of "robo-advice."

I've always emphasized with our team that we're like physicians in the sense that we must know and apply the best science for our clients first. But then —more important—we must behave like clinical psychologists to a great degree and stabilize the long-term relationship to ensure consistent compliance with an appropriate plan. This is why we refer to ourselves as "relationship managers" and not simply "investment advisors."

This is also why we blame ourselves *first* for either losing a client or not gaining a client from "the dark side." Only after we've prescribed all the science-based medicine in our investment bag and applied everything we've learned from behavioral finance and years of advisory experience do we allow ourselves the mental peace of "you can lead a horse to water, but you can't make it drink" when a relationship fails.

Yin and yang

Peterson goes on to explain *why* we don't take better care of ourselves. I don't have the space to summarize his views here, but I was drawn to the view that the world of experience has primal constituents: chaos, order, and "the process that mediates between the two," consciousness.

He describes chaos as the "domain of ignorance" or unexplored territory—where you end up when things fall apart. Order, he says, is explored territory—"where the behavior of the world matches our expectations and our desires; the place where all things turn out the way we want them to."

Peterson uses the yin and yang of the Taoist symbol to represent chaos and order. Order is the white serpent with the black dot for an eye, and chaos is the black serpent with the white dot for an eye. The black and white dots "indicate the possibility of transformation; just when things seem secure, the unknown can loom, unexpectedly and large. Conversely, just when everything seems lost, new order can emerge from catastrophe and chaos. For the Taoist, meaning [and, I would argue, consciousness] is found on the border between the ever-entwined pair. To walk that border is to stay on the path of life, the divine Way."

Take a moment to think about those words in the context of the market decline of 2008-2009. Our approach was to keep our (and your) feet firmly planted in the order of asset class investing and a structured rebalancing discipline as many investors and advisors gave in to the chaos of panic and fear. This led, inevitably, to the highest-cost behavior in which investors engage: market timing (as shown by aggregate mutual fund cash flows). Many advisors—including a large portion, sadly, of DFA-centric advisors—engaged in "stealth" market timing by replacing a portion (sometimes substantial) of a diversified stock portfolio with a slew of mostly complex and opaque "alternatives."

It's safe to say, given what we've observed over the last nine years, that most of these investors and advisors regret allowing their base instincts and emotions to take over when more order was clearly the better path. It's cost them dearly. And many are still searching for that order today.

Order with priority and focus

People often ask why we don't call ourselves "financial planners." I can tell you it comes initially from my experience in the industry as I was first exposed to the "one-stop-shop" mentality of the big brokerage firms. That turned out to be nothing but very expensive, packaged chaos that kept investors blissfully ignorant as stockbrokers picked their pockets—amateur financial planning at its worse.

When I started my own fee-based investment advisory firm, my first peer exposure was to advisors who wrapped a long-term investment strategy in a financial planning overlay. While that wasn't inherently bad, what I observed was that a relatively fixed set of estate and tax planning challenges that would need to be updated as tax laws changed became the project tail that wagged the investment dog. These services were positioned as the primary "value add" in the advisor/client relationships, to the point where accountants and attorneys were often hired as in-house staff.

Despite what many traditional financial planners will tell you, this business approach de-emphasizes long-term investment strategies in ways that are much more detrimental to clients' financial futures than the planners are willing to admit. In effect, they subordinated the importance of their investment knowledge to the perceived (and real) value of legal and tax expertise—expertise many clients appropriately seek outside a formal financial planning model.

In our view, this leads inevitably (but not always) to suboptimal investment experiences over very long periods of time. We know this more broadly than clients because of our peer interactions. Because "highly personalized and customized" tax and estate plans are the primary value focus, many firms employ an overall investment philosophy designed more to *avoid client objections* in the marketing, educational, and ongoing counseling stages than to maximize client wealth.

This leads to what we call "kitchen sink" investing: throw in every investment currently promoted as a viable "asset class" by an industry seriously afflicted with ADHD, acquiesce to client fears during extreme cycles, suffer the inevitable negative consequences, and quickly divert conversations to avoiding taxes, controlling spending, passing on assets to beneficiaries in a tax-efficient way, and so on. Portfolio allocations tend to change along with economic and markets cycles in this model.

In contrast, we believe investing consistently over as many years as possible with a strategy that boils risk and return down to the core and is applied with appropriate and consistent discipline will result in the highest level of wealth creation for investors. We can then work around the edges of an *investment plan* with thoughtful tax and estate planning to gain some additional marginal benefit.

Ours is an approach firmly planted in order yet always aware of the chaos around us. It's the skill in walking the path between the two that sets us apart from our peers, the robo-advice offerings, and those who basically sell you the pills and walk away.

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