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Lessons for a Young Profession

What the 40-Year-Old Financial Planning Profession Can Learn From the Economic Crisis

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Recognizing that estate planning attorneys receive a large portion of their clients via referrals from financial planners, it is important for attorneys to have an inside look at the “roller coaster world” in which planners have been living for the past 18 months and the lessons we learned. Significantly, December 2009 marked the 40th anniversary of our comparatively young profession and its emerging body of knowledge.

The economic crisis that came to light during the latter half of 2008 has caused some to question the value of financial planning and/or financial advice in general. I have heard comments such as, “What good was it to have an advisor if they weren’t smart enough to see the crisis coming?” and “I could have lost that much money without paying someone to help me do it!” There were also those within the financial planning profession who made a great deal of noise in magazine articles and on industry bulletin boards crowing about how THEY saw it coming and had moved all of THEIR clients out of stocks. “Modern portfolio theory is dead!” was trumpeted in the headlines.

The Financial Planning Association (FPA) held its annual Retreat meeting in April 2009 about six weeks after the market hit bottom in early March. As the 2009 FPA national President, I had the privilege of starting the meeting with a circle gathering where attendees have the opportunity to share what is on their mind and what they are looking to get from Retreat. There was a widely held concern by advisors that they had failed their clients and that the theoretical underpinnings of our profession had been shaken. There was clear anger expressed toward those companies and management teams who were operating with a “too big to fail” mindset. The stress of the previous six months was clear in the pained voices of those in attendance.

From a personal standpoint, I have never worked harder in my financial planning practice than I did from October 2008 through April 2009. The amount of client communication, reading, research and professional discussion was taken to a level that I had never experienced during my 17 years as a financial planner. During that time I continued to stress the

values of diversification and keeping emotion out of the decision making process to a client base that was getting more and more frustrated for being asked to stay the course.

So, what does all of this mean as we approach the end of 2009? Each fall, my firm conducts a meeting with our clients called Goals and Financial Independence. We use this opportunity to help clients take stock of their current financial situation and to also look into the future. Imagine my surprise when, over the past several months, we met with client after client whose financial net worth is ahead of where it was in the fall of 2008 and within a few percentage points of the fall of 2007. The following chart gives further perspective:

	10/10/07	03/09/09	12/01/09
DJIA	14,225	6440	10,471
S&P 500	1565	672	1108

According to my math, the Dow Jones Industrial Average (DJIA) and Standard & Poor’s 500 Index (S&P 500) are still more than 25% below their peak of October 2007. Why then are our clients almost financially whole after a two year roller coaster? It is certainly not because we were one of those really smart advisors who saw the financial crisis coming. Our clients were all fully invested in accordance with their investment policy statements during this tumultuous period. However, there were tactical decisions made during that time that are potentially relevant to future decision making.

Our firm has long been believers in the value of diversification and a long-term perspective when managing money for clients. But, the tech stock meltdown at the beginning of this decade taught us that just because everyone is willing to pay a certain price for an asset does not mean that price is correct or sustainable. Since that time we have practiced what I would call Modern Portfolio Theory “light” or, in other words, a long term strategic plan with shorter term tactical overlays based on current economic conditions. The following are a few examples:

- For several years I wanted to get our clients access to investments in the BRIC countries (Brazil, Russia,

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India and China). First, there were few cost effective, transparent investment vehicles and then the prices of the shares got to a level that made no economic sense to us. By November 2008 the prices of several exchange traded funds (ETFs) that follow the BRIC countries were down over 70% in price from their peak. We made the choice to invest a small portion of our clients' portfolios in a BRIC exchange traded fund.

- In March of 2009, oil was down to \$35 per barrel, which was a drop of over 75% from the peak of 2008. We had last owned energy investments in late 2007 when we thought the valuations had gotten way too pricey for our risk tolerance. Now, in hindsight, it seems it was an easy decision to buy energy when oil was at \$35 per barrel. But, in March of this year, everything you read and heard from the media trumpeted the fact that our economic world was coming to an end and there would be no demand for the foreseeable future.
- At this same time, the yield spreads between corporate high yield bonds (and corporate bonds in general for that matter) and government bonds had gotten to levels that would indicate a huge percentage of companies were going to have to go bankrupt to justify those prices. In our opinion, the rampant fear in the economy did not justify those spreads, so we sold government bonds and bought corporate bonds.

None of these investments changes were an "all in" type of process. By making a few incremental changes where potential value was perceived along with maintaining a consistent allocation to our core portfolio holdings our clients rode out the storm. Rather than blindly holding a portfolio of assets and thinking that they were "fairly priced" at all times, we used a long term strategic allocation with a shorter term tactical overlay based on current economic conditions. We typically rebalance client portfolios every 15 to 18 months. Over the past two years, we conducted four separate rebalances and are getting ready to do so again. Large movements in asset prices dictated making these changes.

I find it interesting that the voices of those same financial planners and advisors crowing last fall about their unusual ability to predict the coming market decline have been conspicuously silent as the financial markets have recovered. No one has been announcing that they called the market bottom on March 9th and reinvested their clients at that time.

As the financial planning profession looks to its future, I believe some valuable lessons have been learned:

1. Modern portfolio theory and asset allocation/diversification still have value and relevance. But, we must be willing to look beyond the short term noise and make asset allocation decisions based on fundamental values of assets.
2. Clients need the calming and stabilizing voice a financial planner provides when everyone around them including the news media, internet outlets, etc., are driving them to make irrational decisions regarding their financial future.
3. Financial planners provide the greatest value to clients when we balance their willingness, ability and need to assume market risk in their financial assets.
4. Financial planners do not now have nor will they ever have a crystal ball to predict the future. A business value proposition based on having a crystal ball has no long term viability.
5. Financial planners must take a more vocal role in reforming our economic system so that "too big to fail" becomes a thing of the past.

I am fond of sharing one of my favorite sayings with clients and other advisors: "This too shall pass." Throughout recorded history, man has used this simple phrase to deal with change both good and bad. This current crisis will pass just as surely as we will have another crisis at some point in the future. Our professional body of knowledge must continue to expand to provide planners and by extension their clients a solid footing for the advice we deliver. Ultimately, financial planners must continue to help create a world where everyone can thrive and prosper.

Richard Salmen, CFP®, CFA, CTFA, EA, currently serves as volunteer president for the 28,500-member Financial Planning Association® (FPA®). Salmen is senior vice president/senior advisor with GTrust Financial Partners in Overland Park, Kan. Prior to GTrust, he held positions with Waddell & Reed, Financial Planning Concepts and Legacy Trust Company.