Client Rebranding

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The advisor who can figure out how to navigate uncertain markets and allocate assets efficiently will gain loyal client advocates. The key is to be able to articulate your processes and philosophy succinctly enough that your clients will understand, and more importantly, be able to repeat your process to others.

I know that we will have another severe bear market in the years to come. I know that the market could fall by at least 50 percent just like 2000-2002 and 2007-2009. I do not know when and I really do not care. Why do I believe this?

The US stock market is extremely overvalued. According to the price to sales ratio for the median stock in the S&P 500, we have never been more overvalued. In other words, we are paying the highest prices we have ever paid for the revenue generated. This ratio displays something terribly concerning about the state of corporate America. The grim reality is that revenue growth is stagnating while prices continue to rise, taking US stocks far above their underlying fundamental value. Fundamentals have been thrown to the wayside as the faith in increasingly larger stimulus programs by central banks have created a resurgence in risk-seeking behavior.

Bear markets usually start from high valuations and often usher in corrections of 50 percent or more, especially from levels indicative of extreme euphoria. It is no wonder that US stocks have gone virtually sideways for two years. In our conversations with advisors, most are not positioned for the potential of a bear market in the next few years. In fact, a majority of advisors have stretched the boundaries by hunting for yield in increasingly risky securities. Low interest rates pushed many advisers and their clients into the presumed safety of dividend paying stocks. Unfortunately, a bear market could crush the accounts of these clients and the businesses of these advisers. The good news is that you can prepare now and create a business that could benefit from the coming bear market.

There are a few reasons why big declines in equities can be good for your practice. First, money tends to go into motion during tough markets. As investors watch their accounts become subject to a relentless downtrend, they seek to move out of the market. The problem is that their advisors are usually telling them to stay the course, ride the market, and invest for the long-term. By the time the client actually is able to fight the advisor enough to liquidate, it is often too late and at the absolute wrong time. Trust is destroyed and the relationship is often never the same. This causes investors to look for alternatives and new relationships.

Second, crisis alpha is the most important outperformance you can deliver to your clients. If you prepare portfolios for a bear market and are able to demonstrate that you protected their assets while there was widespread carnage, your clients will turn into loyal advocates. Your clients will become walking advertisements for you, and referrals and introductions will come pouring in. Bear markets will create a stream of in-bound leads, straight from the best source: your current book of business.

Lastly, a massive down market seems to get rid of the competition. Most advisors hide under their desks and spend their times fighting fires, trying to hold onto their current clients. This provides an amazing opportunity to advisors who are actively searching for new clients. If you offer a compelling narrative about how your investment approach protected your clients, you can attract a significant amount of assets during a bad market.

Floyd Mayweather, the now retired boxing superstar, had a bizarre training ritual that would involve him training at the early morning hours, sometimes as early as two o'clock in the morning. When asked why he did this he stated that he wanted to train when he knew his opponent was sleeping. Wealth Management is a competitive business and most of the competition is sleeping right now. We feel it is time that you prepare your clients and their investment portfolios for a probable bear market in the coming years.

How does one do this? There are obviously several ways you can prepare. We always recommend that an advisor start reviewing the risk tolerance of each and every one of their clients. One great way to do this is to stress test their portfolios using tools like Hidden Levers, Riskalyze, or MoneyGuide Pro. It is important that your clients begin to mentally prepare for what could potentially occur in the event of a market decline.

Another important step is to analyze the current portfolio of your clients and construct an allocation that can weather all types of markets. This is not as simple as positioning the whole portfolio in cash and waiting. Cash is better than losing money, but there are often strategies that can gain while the market declines. Furthermore, if the market continues to rise, your investors may miss out. Overvalued markets can often become more overvalued before eventually declining. Portfolios have to be positioned for multiple possibilities.

I recommended using simple, responsive asset allocation systems to navigate markets. We illustrated an example in our book where we combine value-based asset allocation and trend-following to develop a rules-based portfolio construction methodology. The Value Allocator is a long-term system that measures investor sentiment to steer the portfolio opposite of extreme behavior. The trend system is designed to increase exposure to assets that are expected to rise and avoid assets that are expected to fall. If a major market collapse occurs, then both systems theoretically can work to protect the investor.

You could also diversify by allocating to managed futures for a portion of client portfolios. Managed futures portfolios are usually comprised of several different markets including commodities, equities, bonds, and currencies. These strategies also invest short and long-term, providing a historical negative correlation during market declines. This is exactly the type of diversification you need: not the type that spreads exposure over style boxes or even international markets, but the type that protects portfolios.

We believe that now is the time to prepare for a down equity market in the US. Instead of worrying about it, advisors should embrace the inevitability and use it as a way to build stronger relationships and more intelligent portfolios. If you can navigate your clients through a difficult market, you will have a dedicated sales force of loyal client advocates. Stop fearing a bear market and start preparing to take advantage of it to strengthen and grow your business.

If you simply take the steps necessary to implement an investment process that can protect your investors in the event of a major market correction, I am confident that your business would grow and thrive. The key is to be able to do this in a repeatable way that is easy to understand. If it is too complex, your clients will not stay in your process through the hard times.

Take trend-following for instance. I am completely sold on the fact that this is the best way to manage money. Trend strategies take advantage of the strongest factor of investment returns, momentum. The momentum factor has been backed by reams of academic research and the track records of some of the best money managers in history. However, this does not mean that all of your clients will understand and stick with trend-following during the tough times.

Trend-strategies tend to look very different from the broad market indexes at times. For instance: a sideways market, like the most recent 2014-2016 period, can provide a lot of false signals to a trend-following trader. This means that their strategy would suffer a lot of small losses that add up to a drawdown. Try explaining this to your clients when the market is up a few percent or flat. This is not the best discussion.

For that reason, I combine trend-following with a value-based core that is primarily invested in broad market indexes. As long as I do a good enough job explaining to the client that they have a custom benchmark, they are pliable. The reality is that your clients do not want surprises, they want to know what to expect. My advice is that you keep your process and philosophy simple enough to be described on the back of a napkin.