Getting the Most from Your Investment Committee

By Bob Veres
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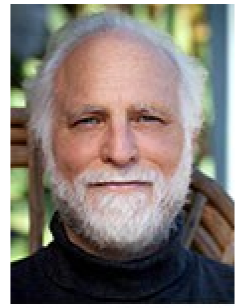

Bob Veres

Investment committees are a little bit like fingerprints: they come in all shapes and sizes, and no two are exactly alike in form or function. So advisory firms that have investment committees – or are considering creating one – can learn a lot from one another. My research has identified some best practices for this flexible management tool, by comparing notes among advisors on how they are managing their IC teams.

Part one of this report identified ten reasons RIAs have investment committees (ICs), such as getting everyone in the firm to understand a common investment philosophy or brainstorming ways to produce alpha in client portfolios. But the widespread adoption of ICs is a recent phenomenon, and for many advisors the more difficult question than "why have an investment committee?" is "how do I make it worth my while?"

Let's look at how different advisors have structured their ICs and identify some of their most important features and practices. As you read, ask yourself: Will any of these ideas help me maximize my investment (of my own time and my staff's) in my IC?

The size and scope of your committee

When I surveyed readers of my *Inside Information* service about the optimal size of their investment committees, responses tended to reflect the size of the practice. Smaller advisory firms reported committees consisting of a principal and a staff advisor. Others reported committees with three, four, five, six and ten members, and one said that the IC should include however many advisors and senior analysts you have in the firm, which will increase over time. "Each of our professionals participate," said Rick Adkins of the Arkansas Financial Group in Little Rock, Ark. "But," he added, "I don't know what you would do if you had forty professionals."

Tim Dwight, of True North Advisors in Dallas, argued that the key consideration is not the size of the committee, per se, but the diversity of advice. "The important thing is having people with different points of view, or different ways of looking at the world," he said. "You want to include different backgrounds, different levels of experience."

"You only want to include people who enjoy investments," Dwight added. "That may sound crazy in this business but some people enjoy selling or visiting with clients, and for them, investing is a vehicle – not their passion. People without passion don't add much to the conversation."

What roles are different members of the committee expected to play in the meetings? Once again, the answers were diverse. One approach is to give the research chores to one person, while the rest of the team provides analysis. In Adkins' investment committee, he has one person prepare the information for the meeting, and the rest of the group discusses items and agrees on changes.

Phil Taggart of Taggart Financial Group in Houston, meanwhile, takes the opposite approach, having each member of his committee tackle whatever research projects fit their expertise. "Members of our committee may have from one to eight or ten areas of specialization," he said. Examples he gave were "macroeconomics, inflation, income, fixed income sector review, geographic review, capitalization review, timing and market technology."

Somewhere in between you find Elyse Foster, of Harbor Financial Group in Boulder, Colo., who advocated a flexible division of the research chores. "We split up by asset class, then by vendor," she said. "One person handles PIMCO and Oppenheimer, for example, so she gets to know the companies and representatives and products. We rotate the data-gathering on economic trends each month."

How often do investment committees meet? That depends greatly on the firm. Pinnacle Advisory Group, in Columbia, Md., occupies the most frequent end of the spectrum; its investment committee meets twice a week. "Monday meetings are to address administrative and trading issues for the team as well as any writing or marketing commitments that must be met," said Ken Solow, the firm's chief investment officer. "We might also discuss weekend investment news. Wednesday meetings are for portfolio review and include discussions about portfolio performance, volatility, macro-economic issues, reviewing securities we own, discussing possible new investment ideas, etc."

At the other end of the spectrum, Mark Lamontagne, of Ryan Lamontagne, Inc. in Ottawa, Canada, said his investment committee meets quarterly. "But we move it to monthly in a bear market," he added.

If there is a pattern here, it may be that meetings tend to be more frequent as ICs take on more responsibilities. Often, this means a more complicated schedule that addresses different types of concerns in gatherings of different length. Take Peggy Cabaniss, of HC Financial Advisors in Lafayette, Calif., for example. Her IC holds two meetings at the beginning of every quarter, each of which lasts around two hours; additional, shorter meetings every Wednesday morning; and twice-annual client workshops.

The quarterly meetings have specific objectives, Cabaniss explained. "The first meeting is a review of the economy, the markets, the current issues affecting stocks and bonds," she said. "At this meeting we set the ranges for all asset classes and industry groups for the upcoming quarter and decide whether to underweight or overweight." At the second meeting, Cabaniss's IC discusses the company's selected mutual funds, and those the firm is looking at. "Funds are ranked within their asset class and are sorted by R-squared," she explained. "Normally we are looking for funds that have fallen to the bottom of the list for several quarters as these are candidates for selling." Afterwards, each advisor is sent back to the office to review the portfolios under their care.

The every-Wednesday meeting, meanwhile, is devoted to a discussion of market issues, any changes to the quarterly guidelines, and specific investment opportunities. Finally, the HC Financial investment committee hosts two client workshops a year, where committee members present in-depth reviews that help define the firm's outlook on the markets and the clearest ways to communicate it to participating clients. "We've done this for about three years, and have a group of about twenty clients who come to each workshop and seem to enjoy it," said Cabaniss. "Most of these clients are very knowledgeable about the markets and appreciate our in-depth presentation."

Refining your IC processes

How should an IC reach decisions? Should the committee chair have final decision-making authority? Nearly all the respondents to the survey said their committees are governed by consensus, although one response – "generally we argue until we have a consensus," offered by Brian Kazanchy, at RegentAtlantic Capital in Morristown, N.J. – probably captures the dynamic more clearly.

Foster, of Harbor Financial Group, had the most autocratic committee structure among respondents. "We all vote, and then I decide," she said, only somewhat jokingly. Norm Boone, founder and principal owner of Mosaic Financial Partners in San Francisco, defined the opposite extreme of responses. "Oftentimes I'm over-ruled by the IC, and that can be frustrating" he said. "But it means that the decisions we make as a group are ones that everyone buys into, because they have had a real say in them. I can't say whether or not they are better decisions," he adds, "but since we work on a consensus basis, it means that we all are largely in agreement with the decisions that get made."

Melissa Joy, of the Center for Financial Planning in Southfield, Mich., represented a common middle ground when she said: "We're consensus-based because we all have to be able to live with the decision." Meanwhile, Bob Haley, of Advanced Wealth Management in Portland, Ore., has a pragmatic approach to resolving disputes. "If there is no agreement, then the decision is based somewhat upon the intensity of one person's feeling about the topic," he said. "But ultimately the authority rests with the individual who is the lead advisor on the account."

Doesn't this committee approach make it more difficult for the firm to reach investment decisions? Ron Rogé of Ron Rogé & Associates in Bohemia, N.Y., said his individual advisors would say so, because since the investment committee was formed they've had to sell their ideas to the committee's members. Lamontagne, the Ottawa-based advisor whose committee usually only meets quarterly, also conceded that his firm's investment committee has to work harder to reach decisions than he did when he had total control. But he added that he now has more confidence in the decisions that are made, which in his mind represents a positive tradeoff.

In fact, the idea of exchanging speed and efficiency for confidence and professionalism was a theme that emerged in response after response. Joy spoke for several respondents when she acknowledged that decisions are harder to reach now that her firm's IC is in place. "But we don't view that as necessarily a bad thing," she said. "Making quick, easy decisions usually isn't a formula for success in the investment world."

Peter Eickelberg, of Keats, Connelly & Associates in Scottsdale, Ariz., saw it both ways. "It's harder in the sense that you have to ask more people," he said. "It's easier in the sense that you have other views to help finalize a decision." David Morganstern, of Confluence Wealth Management in Portland, Ore., pointed out another benefit of groupthink. "It spreads knowledge and fosters commitment, both valuable benefits," he said. "At the end of the day, the advisors who service our clients have to know how we're investing for them."

How do you measure success?

We also asked a very to-the-point question of our respondents: Are you making better decisions through the investment committee than you were making on your own? Almost everybody said yes, but how people defined "better" varied considerably. "Our investment decisions are made with more information and are made in a more systematic fashion than they were when we didn't have a team approach," said Solow, of Pinnacle Advisory Group. "We strongly believe that having a team mitigates the risk of having a 'rogue' manager or a manager who hits a 'cold streak.' The team provides a system of checks and balances that leads to good decisions leavened by contrary opinions that we encourage people to express as part of our team culture."

Adkins, of Little Rock Financial Group, defined "better" in similar terms, saying that the decisions made through his investment committee are less "seat-of-the-pants." Rogé liked the fact that his firm's decisions are now more thoughtful, more dispassionate, and more consistent than they were before he instituted the IC approach. Joy agreed. "More than anything," she said, "there is a more consistent execution of our firm's investment philosophy."

But I suspect that many readers had a different definition of "better" in mind. Does an investment committee improve performance? And, if so, how do you measure that?

Interestingly, more than half the advisors who participated in the survey said that they have no expectation that their committee processes translate to superior investment performance for their clients. Randy Brunson, of Centurian Avisory Group in Atlanta, Ga. spoke for many in the survey when he said that above-market performance should not even be a goal of an investment committee. "The hunt for alpha can be a worthwhile pursuit," he said, "but I don't believe it's a viable deliverable in a planning setting."

Greg Friedman, of Private Ocean in San Rafael, Calif., said that it's possible that his firm's committee will help improve investment performance, but that isn't the focus. "For us the goal is to make the best investment decisions we can make. If an outcome of that is better return, so be it," he said. "If the outcome is the same return with lower risk, so be it. But the truth is, the goal is to make the most educated, rational, thoughtful investment decisions you can make without the benefit of perfect foresight."

A few advisors were willing to speculate about how higher returns might result, even if they aren't expecting or tracking it. "I suppose the investment committee can add value from preventing frantic, ad hoc decisions by one particular principal/advisor on a bad day," said Casey Bear, of Cranbrook Wealth Management in Troy, Mich. "But that is impossible to measure."

Dana Anspach reports that her investment committee at Sensible Money in Scottsdale, Ariz. actually does try to measure some of the performance differences between committee decisions and hypothetical "other" decisions in an interesting – and possibly unique – way. "We look at what we would do if we had could build a portfolio that was completely free of career risk," she said, adding that her firm borrowed the idea from an article by Jeremy Grantham. "If I really thought I should exit stocks," she said, "I still might not do it because of career risk. We document what we would do if we could do anything. Then we can go back and see how that would have actually played out. It's a fun exercise," she said.

But a plurality of advisors agreed with Dwight, of Dallas’s True North Advisors, who believes that performance is indeed improved by the IC process, even though he doesn't track it with any precision. "Having an IC helps to identify both risks and opportunities that a single individual might not see due simply to lack of time to do research, or personal bias," he said.

Eickelberg said that the committee helps his firm stay consistent with its published investment philosophy, and Adkins thought that consistency alone may be enough to move the performance needle. "To the extent that we're truer to the allocation established for each client, performance should be improved in the long run," he said. "To the extent that we use the most-efficient investment options for each bucket, long-term performance should be improved. Our primary measure of effectiveness is having portfolios with significant variance from targets addressed daily, and running lists of investments that are no longer on the approved list, to make sure that inefficient investments are actually removed from portfolios."

Elaine Bedel, of Bedel Financial Consulting in Indianapolis, thinks that her firm's investment committee can improve returns simply by facilitating prompt attention to problems and opportunities in client portfolios. "We believe our investment committee helps improve performance, as it allows us to set timetables on investment changes and helps keep us on track with implementing new ideas," she said. "We keep a short one-page running document on any outstanding items from our meetings. This helps ensure that we stay on track. Putting a date next to the outstanding item," she adds, "seems to automatically put some urgency on some outstanding issues."

Perhaps the most interesting perspective on whether ICs improve return came from Kazanchy, of RegentAtlantic Capital, who has tracked performance and found mixed results. "The committee does improve performance based on the criteria we have set for evaluation," he said. "However, the improvements are not as large as we would like them to be. We run extensive attribution analysis to break down the results of past investment decisions versus our custom-defined standard diversified portfolio of market indices," Kazanchy added. "Over the past five years, we have achieved consistent positive attribution from manager selection and an inconsistent mix of positive and negative attribution from tactical asset allocation shifts."

The downside to decisions by committee

Are there any drawbacks to making investment decisions in a committee? Dwight spoke for many when he cited paralysis and groupthink as potential dangers. "Sometimes it is appropriate to do the opposite of what the herd is doing," he acknowledged. "That's especially difficult when the IC itself could be considered a herd of sorts." Is there a cure for herd thinking? "On our IC, we always have someone – usually me – playing 'devil's advocate,'" he said. "I help offset other people's biases and look for risks, and others are encouraged to do likewise."

Kazanchy acknowledged the dangers of groupthink, members' inherent biases, and reluctance to challenge one another. But he thinks that these difficulties can be handled administratively. "I believe high-performing committees will have members debate both sides of an important decision," he said. "Members need to learn to open their minds and challenge themselves to advocate for ideas that they normally would not support. If done well, I believe this helps the committee better understand the downside risks."

Bedel's firm addresses the risk of groupthink in a more formal way, by creating an "external investment committee" to help the internal IC. "We invite two investment professionals from outside of our firm to sit in on the committee for a two-year period," she explained. "We meet quarterly to discuss what we're doing and to get feedback from the outside members. We also want to be able to help the outside members on any investment issues they're working on, so that they find value in participating in the committee."

Morganstern, of Confluence Wealth Management, concedes that 'analysis paralysis' has been a drawback and time-consumer on his investment committee. "Strong personalities, strong opinions and biases have taken time to work through," he said. "But delegating all investment decisions to our portfolio manager is not acceptable, since we partners carry all the risk, while he has none as an employee. We also," he added, "have a lot more client-facing experience, so we have to explain what went wrong in portfolios if we made poor decisions."

Friedman, of Private Ocean, said that the tradeoff is speed for collaboration. "But, given our core investment philosophy, we engage very strategic – rather than tactical – allocation, so speed in decision-making is not a major factor for us," he said. "I think it is a good thing if you have to think twice when you might be tempted to respond impulsively. It might be a check and balance."

Bear said that deliberate decision-making can reduce costly mistakes. "I find that most RIAs get in trouble when they talk themselves out of their traditional approach, into something new and sexier," he said. "When a committee of people you respect and trust all arrive at the same conclusion, I actually think it is easier to pull the trigger – and sleep at night."

Building a flow of new ideas

Many advisors said that the advent of the IC created a beast that is constantly hungry for information. Where does the IC get the flow of new ideas and information on which to base its decisions?

Interestingly, this may be the most undeveloped part of the still-evolving IC process for advisors. The survey consisted of a lot of ad-hoc information gathering, and across the entire thing a common response was some variation of: we try to make time for reading. Morganstern's firm was among the more organized to respond. "We circulate articles and share research that we come across," he said, "and we each go to conferences and speak with wholesalers who all have biases about asset class preferences."'

"We set up a reading folder," Anspach said. "Each month, the following specifics go into the folder: Any commentary, newsletters and forecasts from GMO; the latest commentary from Advisor Intelligence; the latest from Hussman; and the latest from Rochdale."

"In addition," she said, "anyone can drop anything into the folder they think is relevant. Often we drop in articles from *Advisor Perspectives*. This process insures we are all reading and discussing new thoughts."

Eickelberg admitted that this is the least-evolved part of his firm's IC process. "Ideally, we'd have everyone on the committee contributing their own well-researched ideas," he said. "But as our committee is primarily a voting body, the best way to manage it is to have all the research done by specified individuals on the committee. The committee," as he put it, "is a consumer of research, not a producer of it."

Friedman gave one of the most interesting responses, when he said that his firm's investment committee routinely discusses portfolio ideas that were provided by clients. "For example, one of our clients is a senior executive at one of the major investment banks," he said. "Don't think he doesn't come forward and say, hey, guys, what do you think about this or that? And he should. And we listen."

Conclusion

If you step back for a moment, you realize that the sheer variety of approaches across firms sets the IC apart from many of the other practices that advisors adopt. The process of creating a financial plan, or on-boarding a client, or running a quarterly meeting may not be exactly standardized from firm-to-firm, but they are quite similar when compared to the wild diversity of size, goals and approaches that ICs have these days.

In a very brief survey, I've managed to capture a few potential "best practices" – or, at least, some interesting, workable features of ICs, which other advisors can adopt as their own. Now that this exchange is taking place around the many issues raised by what might be called “IC management,” there’s reason to believe that the normalization and evolution of ICs has entered a maturing phase.

To advance the conversation even further, I'd like to invite the readers of this report to participate in a second survey, which will capture a broader cross-section of the RIA community and identify more clearly how ICs are staffed and managed and what they accomplish for your firm. This is a relatively new phenomenon in the RIA space, and like any new and little-understood activity, it is still among the least-efficient facets of most advisory practices. With a bit more information and a continued sharing of best practices, the RIA investment committee can be put to better use as the versatile tool that it is.

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