Expect the Unexpected

**GUEST COLUMN**
BY THANE STENNER, ROD BOWER, AND RORY O'CONNOR

It’s a cycle that repeats itself every few years or so. When a particular industry or geographic area posts impressive gains, investors jump in, expecting the gains to continue. When the sector or area cools down – as it inevitably does – investors are shocked and dismayed.

For you, the advisor, this is a dangerous game. As a professional, you know that markets move in cycles, and over time, performance always reverts to the mean. While you may believe there is money to be made throughout the cycle, you are not naive enough to believe the cycle will continue forever. Clients, however, don't always share this perspective. Even veteran high-net-worth investors will ride a wave of euphoria – as it inevitably does – investors are shocked and dismayed.

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The first step in managing client expectations is to define your role as a financial professional. Who do you want to be: A market magician or a wealth protector? If the former, clients will expect magic from you, and they'll be disappointed. If the latter, they will expect security and peace of mind.

With our clients, our goal is to be protectors of their family's wealth. Every financial decision we make is based on our desire to preserve that wealth for multiple generations. Sometimes that means less participation in “hot sectors” or “flavour of the month” investments. But in the long run, we believe this is the best way for our clients to protect what they’ve worked hard to build.

**Use an investment policy statement:** An IPS is a good idea for any client, and a must-have for a HNW client. Think of the IPS as a kind of “good control.”

If the client points to their quarterly performance and questions why their returns are not as high as XYZ sector, refer them to their IPS. Remind them of their risk tolerance, explain the downside potential of a volatile XYZ sector, then re-focus the discussion on long-term goals. It really can be as simple as that.

**Practice (and preach) diversification:** Diversification is a tried-and-true strategy. It’s effective, but boring. So, you must become a “disciple” of diversification, preaching its virtues at every opportunity.

In our practice, we often talk about diversification, reviewing global market performance and referring to visual tools to show them the folly of “hot-sector” investing. Afterwards, we make sure client can understand the direct link between the strategies we employ to protect their wealth and the quality of life their family. Sell what the news is dictating: Once the news is in the papers, the easy money has been made. Many advisors still do it profitably, but if you do it once, clients will expect it all the time. Instead, position yourself as a contrarian. Sure, this takes conviction, but going against the herd can reap rewards, both in performance and in protection.

**Use alternative assets and other strategies to smooth out the ride:** Regardless of what diversification strategy you use, you’ll want to supplement it with alternative investments and other strategies to reduce volatility and add alpha. We position these strategies not as performance boosters (which they often can be), but as diversifiers. In an era of relatively low interest rates and an uncertain global economy, the lean nature and tax-deferral benefits of private PPNs make them a compelling investment option.

At the end of the day, how you manage client expectations can make a dramatic impact on your ability to attract and retain HNW clients. Allow clients to set their own expectations, and you allow them to dictate the terms by which they will judge your performance as a professional.

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