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Why your Investment Philosophy matters to your clients

Many of the world's leading investors will tell you that nothing is more important to long-term investment success than a clear investment philosophy.

An investment philosophy is based on the intractable belief you have in the principles and practices that guide your decision-making. In times of market upheaval and through the dark of uncertainty, your investment philosophy enables you to control your emotions, shut out the noise and focus on the things that really matter over the long term. Your investment philosophy keeps you focused on the process, which is your investment strategy.

This is particularly important when advising private individuals. As behavioural economics has shown people are in reality much more risk adverse than they might own up to; and that under stress they make highly reactive decisions. In the investment markets this can be very expensive.

To be able to clearly articulate the why of their investments will help your clients in exactly those moments.

An investment philosophy can usually be derived from two mainstream approaches;

1. **Risk Profiling or Strategic Asset Allocation (SAA)**: which typically believes that:

    - Psychometric risk profiling is the most appropriate way to determine an investment strategy - i.e. an investors appetite for gain or tolerance for loss, and
    - Risk means volatility of capital, and
    - History is the best guide to future outcomes
    - Modern Portfolio Theory can be used to build optimal portfolios based on historical data as markets are always efficient and repeatable, and
    - Investors are always adequately rewarded for risk so a long-term Strategic (or Static) Asset Allocation works best, and
  - Markets will always mean revert and dragged by some force of financial gravity return to historic rates and ratios, suggesting there is little value in managing asset allocation.

2. **Goals Based Investing or Dynamic Asset Allocation (DAA):** which typically believes that:

    - Investors actual needs and goals are the most important starting point to determine an investment strategy, and
    - Risk is best defined as the probability of not meeting an investors goals, and
    - Investors will have numerous different goals - so no one strategy or profile will suit all needs, and
    - Markets are not always efficient - risk-reward opportunities arise from time-to-time, and
    - Forward looking estimates and projections are more relevant than historical data - as markets will not always perform as they have historically, and
    - The world is constantly changing - more flexible and broad ranging Dynamic Asset Allocation tolerances can help derive value or protect from capital losses, and
    - Protecting capital is of paramount importance.

Some examples of investment philosophies of well-known investors include:

- **Warren Buffet:** *"Buy wonderful businesses at a fair price with the intention of holding them forever."*
- **John Bogle:** *Buy-and-hold, long-term, all market-index strategies, implemented at rock bottom cost, are the surest of all routes to the accumulation of wealth.*

Other examples of brief but all-encompassing investment philosophy statements:

- *Diversify widely, rebalance regularly, minimize costs; rinse, repeat.*
- *Anything is possible, and the unexpected is inevitable. Proceed accordingly.*
- *Risk means more things can happen than will happen.*

It can be particularly helpful for a financial advisor to be able to articulate the elements of their investment philosophy. It helps your client understand and so entrust you with utmost confidence. Whatever your philosophy or belief's, this will determine your strategy and how to implement it.