

Jason Zweig on Protecting your Wealth

By David Raileanu

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Jason Zweig is the Investing and personal finance columnist for the *Wall Street Journal*. He is also a guest columnist for *Time* magazine and previously wrote for *Forbes* and *Money* magazines. His analysis has been featured on ABC, CNBC, CNN, and NPR. He is the author of [*Intelligent Investor: A Book of Practical Counsel*](#) and of, [*Your Money and Your Brain: How the New Science of Neuroeconomics Can Help Make You Rich*](#), which received widespread critical acclaim when it came out in 2007. His most recent book is *The Little Book of Safe Money: How to Conquer Killer Markets, Con Artists, and Yourself*, which was published in November 2009 and is available from the link above.



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We interviewed Zweig on January 24, 2010.

For financial advisors, what is the most important lesson when it comes to safe money?

If I had to boil it down to one message that probably isn't in the book, it would be that advisors really need to be aware that they're people too and they're subject to the same flaws in thinking and the same emotional tendencies as their clients. There's often a big temptation among people who are experts at what they do, as advisors certainly are, to conclude that they're exempt from the behavior they control in other people.

If you check, you will find that most bookies don't gamble. That's not a universal tendency, however. At least until the past 10 or 20 years, it wasn't that uncommon to come across oncologists who smoked. They spend all day telling people, "If you smoke, you're going to die of lung cancer," but to manage the stress, they step outside and have a cigarette.

I don't want to make a broad sweeping statement that all advisors are reckless, undiversified, return-chasing, risk-seeking crazies who pay no attention to tax consequences – far from it. But there are general tendencies



that really kill investors: things like overconfidence, careless or improper diversification, not paying enough attention to expenses, and having unrealistic expectations. Advisors really need to make sure that, in the process of fixing those problems for clients, they don't suffer from any of them themselves.

You write in *The Little Book of Safe Money* about investing in emerging markets. Do you feel these are safe bets?

One of most common things that I still hear when I talk to financial advisors is, "We're overweight emerging markets because we know they're the fastest-growing economies in the world." What most of them don't realize is that there's essentially no correlation whatsoever between GDP growth and future stock market returns. People find this absolutely shocking. Over the past 10 or 20 years, for example, the Asian emerging market economies have done far better than, say, Latin America. Their stock markets have not.

In the future, it's quite likely that emerging market economies will do about as well as people expect. But the question of whether their stock markets will do as well as people expect is a much more complicated one to answer, mainly because people expect them to do so darn well. To be overweight something that is so obvious that virtually every investor in America knows about it is a very risky thing to do.

I don't think most financial advisors understand that at all. That concerns me.

Your most recent book is about keeping your money safe. You remind the reader that risk is something that you should avoid at almost all costs. What is your definition of risk? Is it exclusively the potential loss of capital, or should investors think about things like volatility?

I've spent my whole working life trying to answer the question "what is risk." For advisors, risk may have a slightly different meaning than for an investor who is working on his own without professional advice. A pretty good definition of risk – a functional definition – would be: you think you understand something when you don't. It could be that if we redefined risk that way, it would become a little more frightening, particularly to advisors. After all, if there's one reason your client hired you, it's to understand the things he or she either can't or isn't willing to try to understand. It's really your job as an advisor to explain the way the financial world works to your client. You'd better make sure you understand the things you're explaining.

Above all else, if you ever find yourself saying the words, "studies have shown that..." I highly recommend that you have read the studies. If, for



some reason, you can't understand everything in the study, then find somebody else who can and get them to explain it to you. I can't tell you how many times financial advisors have said to me studies have shown that something-or-other and after asking a couple of questions it's become evident to me that these people have not actually read the studies. It's a lot like talking about a movie when you've only read the review or seen the trailers. You're on really dangerous ground if you haven't really done the homework.

You recommend Treasury Inflation Protected Securities (TIPS). Their “real” yields are pretty low. Would you advocate for them as the best way to hedge against inflation?

If I had to write the book all over again, I might tone down my praise of TIPS a little because, just like anything else, in the hands of overenthusiastic people, TIPS can do some damage. TIPS aren't perfect. If interest rates rise faster than inflation, somebody who holds TIPS is not going to be very happy. They're definitely not perfect. Are they the best way of combating inflation? I guess I would say, in general, they probably are, but there are big exceptions.

One area where advisors can play a huge role is helping people become more sophisticated in controlling the risks inflation poses to their own human capital. I'm pretty critical of commodities as a general rule, but there are many people whose jobs and the health of their company depend on the price of a particular commodity.

For example, a lot of the inputs in the chemical business are petroleum-based. If you work at DuPont, you are vulnerable to higher oil prices, because when oil prices go up, the price of your company's raw materials go up. For somebody like that, whose job would be hurt by oil prices, investing in oil makes a lot of sense. While TIPS are good general way to combat inflation for the typical investor, most financial advisors would agree with me there's actually no such thing as a typical investor, because everyone's situation is different.

We've seen a recent fanaticism surrounding gold. What role should gold play in an investor's portfolio?

This is an area that comes hard to a lot of people. I don't think gold is the only issue. It's commodities in general. The financial advisory community has fallen hook, line, and sinker for the Wall Street propaganda that every investor should have at least 10 percent of their assets in commodities. That's really unfortunate.



There are a couple problems. The first problem is, in the long run, commodities have earned a negative rate of return. So it's unclear to me why it's a good idea for me to have a permanent long-only position in something that goes down in value. There's a different question though, which is should I have a long-short position in something that tends to go down in value? And that's a much more complicated question.

Now we have to look at a whole bunch of other things, such as why commodities would go up in price from here. Let's remember what commodities are. They're all kinds of things. Some of them are man-made, like currencies. Some of them come out of the ground. Historically, whenever anything that comes out of the ground gets scarce, human ingenuity springs up and invents an artificial substitute. It's already starting to happen for oil, and down the road, it almost certainly will. I'm unaware of any important natural commodity that the human race has ever run out of. If there is one, I'd be willing to bet a substantial amount of money that the synthetic substitute that was created for it turned out to be better and cheaper.

It's hard to be a bull on commodity supply. You have to believe we're running out of it, and when we run out of it that's just going to be tough. We might run out of oil, but if we do, will the world really grind to a halt? I don't think so, because it's so important to the global economy that, once everybody agrees we're running out of it, then everybody's going to try to find a substitute. The price, ultimately, is not going to go up; it's going to go down. Eventually, it will go to zero.

If you're talking about things like precious metals, like gold and silver, you're dealing with an entirely different question, which is essentially the belief that when policy goes bad, gold is good. We just don't really know much about that. It may turn out to be true, but the price of gold was fixed for so long that we have a really small sample of data to base that decision on. Gold was at \$35 an ounce for ages. The price has only freely floated for a couple of decades. If you had bought gold in 1980, which was the last time it was as trendy as it is now, you would have waited a quarter century to break even. I just don't see the appeal.

The entire propaganda infrastructure that has been dedicated to ramming commodities down people's throats is very disturbing. Other than generating massive fee revenue for Wall Street, I would be very surprised if a buy-and-hold, long-only commodity position is going to do anybody any good in the long run.



Where is the empirical evidence that, in the long run, commodities are a good hedge against inflation? There's some evidence for that in the short term, but the long-term evidence for it, in my opinion, is terrible.

It seems that mutual funds, insurance companies, banks, and other “manufacturers” of financial products do not have incentives that align with those of investors. Even so called “fiduciary” financial advisors are rewarded by growing their clients’ assets, which may motivate them to take on more risk than is appropriate. For the average investor, is there anyone that he or she can truly trust?

Well, sure. Most advisors really do have their clients' interests at heart, certainly all good advisors.

Advisors really do need to ask themselves, “Am I eating my own cooking?” Would I put my money at risk the same way I'm recommending that my clients do? Instead of just throwing 10 percent of every client's money into commodities, maybe advisors should ask themselves whether they would put all of their own money into commodities.

Framing the question that way might help them investigate the empirical evidence a little more closely. Reasonable minds can differ, but I personally don't see it.

So should we hold investors responsible for keeping their advisors honest?

Yes. Investors are too passive. It's partly because the nature of the fiduciary relationship is built on trust. Of course, we all tend to forget this, but doctors, in the eyes of the law, are fiduciaries for their patients. It's a term you never really hear used. When I see my doctor, I probably don't ask nearly enough questions. So it's understandable why people don't do that with their financial advisors. You've hired this person; you're comfortable with his or her level of expertise. The whole reason you're listening to this advisor is because you think he knows what he's talking about. People do tend to shut their brains down. That is unfortunate. Many advisors do get a kind of free pass from clients. And that's not good for either side.

Clients need to ask advisors a set of questions before they formalize their relationship. Advisors need to ask clients a set of questions, too. If the clients don't know the right questions to ask, then the advisors should help them. They should say, “You really should have asked me for my form ADV,” or, “You didn't ask me how I'm compensated,” or, “You didn't ask me how I define a conflict of interest, so let me tell you about those things.” I know a lot of that does go on, but standardizing it would not be a bad idea.



Jason Zweig recommends the following resources for keeping up with trends and ideas in the field of behavioral finance:

- **Farnam Street** <http://1440-68131.blogspot.com/>
- **Psy-Fi** <http://www.psyfitec.com/>
- **Research Digest Blog** <http://bps-research-digest.blogspot.com/>

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