Can Index Funds Replace an Advisor?

finance.yahoo.com/news/index-funds-replace-advisor-163155945.html

Lou Carlozo

In a few short days -- Aug. 30, to be precise -- billionaire Warren Buffett will turn 89 years old. Worried investors should note that Charlie Munger, Buffett's sidekick at Berkshire Hathaway (ticker: BRK.A, BRK.B) in Nebraska, is a very sharp 95.

If you're wondering at this point what the devil counting birthdays has to do with investing, consider how Buffett wants to provide for Astrid Menks, his wife since 2006. For fund managers, Buffett's 2013 letter to Berkshire Hathaway shareholders might as well serve as a sharp stick in the eye:

"One bequest provides that cash will be delivered to a trustee for my wife's benefit," Buffett wrote. "My advice to the trustee could not be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund." (He suggested Vanguard, by the way.)

The Oracle of Omaha concluded: "I believe the trust's long-term results from this policy will be superior to those attained by most investors -- whether pension funds, institutions or individuals -- who employ high-fee managers."

Or, you could say, Ouch. Buffett insists you don't need a Wall Street type to manage your investments after all. Invest in the index, cut out the middleman and reinvest those saved fees to realize huge rewards over time through the magic of compound interest.

The subject of fees and the financial managers who charge them has hardly been a sweep-it-under-the rug affair for investors. The conversation has in fact heated to contentious levels, some of the credit or blame courtesy of the "Freakonomics" public radio show. In case you might've missed it, episode 297, dated March 21, 2018, was titled "The Stupidest Thing You Can Do With Your Money."

On it, Stephen J. Dubner reaches a well-reasoned conclusion -- backed by financial industry immortals -- that the money spent on fees is a waste when compared to the strategy of the passive fund that tracks a market index. He cites a study where only the top 2% to 3% of active fund managers had enough skill to cover their cost.

But how far can Buffett's stock market strategy be taken portfolio-wide for the typical investor? After all, 99.99% can't leverage a Buffett-sized fortune and place it in an index fund. Thus many industry experts contend that if you try Buffett's approach as a one size fits all, you might as well climb into a potato sack and call it a three-piece suit.

"Without an advisor what factors would an investor use to decide which indexes to invest in, at what percentage and how should the investment allocations change over time?" says Ken Stern, senior managing director of Lido Advisors in Los Angeles.

"I disagree that low-fee index funds are an adequate replacement for an advisor," says John Foxworthy, founder of Foxworthy Wealth Advisors in Fort Wayne, Indiana.

"These vehicles are changing the concept that an advisor is a 'stock picker,' but there is much more to it than that," Foxworthy says. "The individual exchange traded funds are just ingredients. It takes a good chef to be able to combine those ingredients into a delicious meal."

"If the goal is simply to invest money indefinitely then a low-cost index is perfect and a great part of executing a financial plan," says Adriel Tam, CEO and co-founder of Viridian Advisors in Seattle. "However if you have a time horizon like retirement, college planning or a need to use the investments at a later point, then no."

Tam's observation raises a salient point: Market index funds and paying an advisor need not represent an all-or-nothing choice.

"We do not believe the decision to use index funds or to have an advisor are necessarily mutually exclusive," says Geoffrey Sulanke, director of manager research at Davenport & Company in Richmond, Virginia. "Just as you would not try to build a house without a blueprint, you should not approach your finances without making some type of plan before you begin."

Ah, ha! No two homes are alike, nor are the resources to build them or the ultimate goals they serve. So getting your financial house in order can be risky business if you spend too much time making sidelong, envious glances at your neighbor's pad.

Likewise, no two advisors charge the same amount.

"There are so many advisors that you can shop around for advisors who charge the least fees," says Mayra Rodriguez Valladares, managing principal at MRV Associates and a bank regulatory and capital markets consultant based in New York. "Always make sure to ask your advisor what he or she invests in to see if they have skin in the game."

Investors will benefit from periodically reviewing their assets, how they are allocated and how their efforts to diversify are faring in the stock market.

Robert Johnson, a finance professor at Creighton University and longtime follower of Buffett, understands the billionaire's approach in fine detail. Thus he's able to break down The Oracle's proclamation in everyday investing terms.

That is: While the numbers say one thing, investors too often do another and it's often frustratingly flawed. So the purpose of a great advisor might be -- and often is -- to protect people from themselves.

"The biggest advantage of an advisor is not the financial expertise provided or the investment decisions made," Johnson says. "It's that she will calm you down during times of market turmoil, talking you out of panicking and making sweeping changes to your portfolio."

Daniel Kern, chief investment officer at TFC Financial Management in Boston, agrees with this brake on investing emotion.

"Advisors are a necessary counterweight to many self-destructive behavioral tendencies," Kern says. "It's easy to lose perspective in a soundbite-driven environment that magnifies the natural fight or flight response under stress, which often leads investors to trade too much and to trade at the wrong times."

And unfortunately, some investors -- even those ensconced in an ETF -- feed off manic energy to reckless ends.

"Anyone can buy an index fund," says Steven Jon Kaplan, CEO at True Contrarian Investments. "A true advisor will keep their clients in alternatives during bear markets even if that means something boring like four-week U.S. Treasurys and/or bank CDs."

That said, you could ride out the biggest of bears if you're willing to adopt the supremely patient *modus operandi* of Buffett. He famously said his favorite holding period for a stock is "forever." And as he closes in on 90, he's as close to that mark as anyone.