

The Active Manager

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6 Do's and 6 Don'ts of a Successful Advisor's Practice

BILL BACHRACH, CSP, BACHRACH & ASSOCIATES, INC.

MOST FINANCIAL ADVISORS SAY THEY WANT TO build a business that generates a sizable income and lets them live the life they want. Yet few advisors consistently do what it takes to create that kind of business. They seem to be very busy, but they're actually engaging in something I call work-avoidance behaviors. If you want to build a successful business that lets you meet your financial and life goals, you need to uncover and eliminate work-avoidance behaviors from your daily routine.

Work-avoidance behavior includes just about anything that doesn't really serve your clients. Here are six typical examples that I see again and again.

continued on page 6



FROM THE PRESIDENT

The Hidden Value of NAAIM

OVER THE PAST FEW WEEKS IT HAS BEEN THE spirit and generosity of all Americans that has given hurricane Katrina's victims the biggest lift. Nowhere was that spirit and generosity more evident than here at NAAIM.

As some of you are aware, the disaster directly impacted several of our members. **Charlton Jones** of *Keystone Capital Management*, **Mike Jones** of *Argent Financial Group*, **John Dalton** of *JDC Financial Management* and **James Olsen** of *Olsen & Guidry, LLC* experienced significant losses. Thankfully, all are well and accounted for.

Shortly after the true impact of the hurricane was realized, NAAIM members jumped into action, first locating our Gulf Coast colleagues, then offering support. Led by the efforts of Peter Mauthe, Jerry Wagner, and Jim Applegate our members offered to provide office space, technological support, and lodging for staff and families displaced by the hurricane.

As an organization we hold ourselves to high standards, both personally and professionally. We are a group that helps our members survive, whether through the exchange of ideas and experiences, or by lending a hand to a friend in need.

If you know of any other members who need help, if you're trying to locate someone, or if you'd like to offer help, please post word on the message board (Advisor Exchange) at www.naaim.org. If you need to be registered to log on to the message board, please contact Susan Truesdale at 888-261-0787.

Further to our goal of educating the membership, included in this issue are several compelling articles. One in particular, "No Such Thing", by Maggie Mahar, does a better job than I could ever do of expressing my beliefs about investing and why I do what I do. I hope you get as much out of it as I have. I also highly recommend the books referenced in the article, Bernstein's *Against the Gods: The Remarkable Story of Risk* (John Wiley) and Taleb's *Fooled by Randomness: The Hidden Role of Chance in the Markets and in Life* (Texere).

Enjoy!

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No Such Thing

MAGGIE MAHAR

You're more likely to run across a black swan than to find a sure bet in the financial markets. A pair of noted risk experts say certainty is for the birds.

WALL STREET RARELY TALKS ABOUT THE ROLE sheer chance plays in the stock market. After all, most financial professionals make their living forecasting the future. Who wants to dwell on the fact that the future is unpredictable? But there are those on Wall Street willing to acknowledge that in a world made up of probabilities, nothing is certain. In his landmark study of risk, *Against the Gods: The Remarkable Story of Risk* (John Wiley), Peter Bernstein makes clear that although the laws of nature may be immutable, within the realm of human affairs, no rules can be extracted from the past and applied, with confidence, to the future. Bernstein, who began his career as a portfolio manager in 1951, has spent the past 29 years working as an economic consultant to institutional investors, and he knows that all of the charts, computers, and mathematical models in the world cannot tell us, with any certitude, what the market will do tomorrow, next month, or next year. "Surprise is endemic in the financial world," says Bernstein, and the risk of being surprised is not measurable. He quotes economist John Maynard Keynes on the nature of uncertainty in financial markets: "There is no scientific basis on which to form any calculable probability whatever. We simply do not know."

Nassim Nicholas Taleb adds the punch line: "The most dangerous error that an investor can make is to mistake probability for certainty." The founder of Empirica Capital, a trading firm in New York, Taleb is a student of risk and a professional risk-taker. In 2001, he added his voice to the debate about risk and risk management with a book that has rolled down Wall Street like a small hand grenade, gathering notice as it goes. *Fooled by Randomness: The Hidden Role of Chance in the Markets and in Life* (Texere) challenges many of the assumptions about risk management that prevailed throughout the bull market of the 1990s.

Like Bernstein, Taleb recognizes that whereas people resist randomness, markets resist prophecy. The fact that something has happened many times in the past doesn't mean it will happen in the future. The fact that it has never happened doesn't mean that it can't happen. "All we can learn from history," Taleb says, "is that the unpredictable will happen—and does—time and again."

Taleb and Bernstein don't agree on everything. In the end, they offer investors very different advice on how to manage risk. But, taken together, their thoughts provide an assessment of the challenges investors face that is both provocative in its insights and startling in its honesty. Both agree that when investors bet on a probability, they must ask themselves not

"how probable is it that I will be right?" but "how grave will the consequences be if I'm wrong?"

Taleb and Bernstein also agree that investors must, at all times, expect the unexpected. Taleb calls the unexpected "the black swan," or "the rare event" that lies outside of our experience: we have never seen a black swan, just as, until the '90s, we had never seen the Dow Jones industrial average climb 1,000 points in less than four years. In fact, it took the benchmark index 76 years just to reach 1,000, a barrier it breached in November 1972. Another 14 years elapsed before the index hit 2,000 in January 1987. Dow 3,000 came four years later, in the spring of 1991. Four years after that, in February 1995, the index broke 4,000. But the bull was just warming up; before the year was out, that rough beast jumped over the moon, breaking 5,000. This time it had taken just nine months. Based on past experience, such jumps seemed, to many, highly improbable—some would have said unimaginable.

Taleb also argues that often we find patterns in data where there are none. "Randomness generates pseudo-patterns," he observes. "If you asked a computer to randomly generate a series of zeros and ones, eventually you would find patterns—say nine zeros in a row, preceded by two ones." Similarly, financial pundits who scan market history may think they have found a correlation between stock market dips and changing hemlines or stock market booms and presidential elections when they are simply imposing perceived causal relationships on the randomness of reality. Even when we say that, in the past, the stock market recovered "because" the Federal Reserve cut rates, we can't be at all certain. In the financial markets, Bernstein points out, "each circumstance is different. You can never duplicate the experiment under exactly the same conditions," and as a result, it is very difficult to say that "x caused y."

Financial history is studded with surprises that defy our efforts to find formulas, Bernstein observes. As an example, he points to that period in the '50s when low-risk, high-grade bonds offered a higher yield than stocks. Previously, stocks always paid higher dividends than AA-rated bonds. But abruptly, in the '50s, "for the first time in history," Bernstein notes, the old rules were turned on their heads: bonds paid the higher yield. "A relationship sanctified by more than 80 years of experience suddenly came apart."

Similarly, he points out, "in the early '70s, long-term interest rates suddenly rose above 5 percent for the first time since the Civil War." Again, what had seemed improbable to the point of being nearly impossible had occurred.

A black swan could appear tomorrow. The stock that everyone said was a safe haven could blow up.

“These paradigm shifts may not have been unpredictable,” says Bernstein, “but, at the time, they were unthinkable.” And in May 2003, Bernstein noted, with the yield on 30-year Treasuries hovering just a hair below 4.8 percent, the paradigm has now been breached in the opposite direction.

We expect the world to be linear and regular, says Taleb, and that is why we are caught off guard by those events that break with the sure patterns of the past—or what we thought were the patterns of the past. For example, we have been told repeatedly that on average, over a 10-year period, the stock market returns roughly 10 percent. But what of those two separate 20-year periods during the last 100 years when the market returned only 2 percent, after inflation? How does an investor calculate the odds that at some point the market might average even less than 2 percent over 20 years—or that he might find himself stuck in just such a dry spell?

Financial markets defy such calculations, Bernstein and Taleb agree. In the physical world, it's much easier to calculate probabilities because the possibilities are more likely to be finite and clearly defined. “If you roll dice, you know that the odds are one in six that the dice will come up on a particular side,” says Taleb, “because you know the dice have six sides. But, in the stock market such computations are baloney—you don't even know how many sides the dice have.”

Because the physical world offers a limited range of possibilities, events tend to arrange themselves on a bell curve. Again, Taleb offers a practical example: “Let's say you graph the weights of all the babies born in the United States over 10 years. Birth weights might range from under a pound to, perhaps, 15 pounds. If you took a large enough sample, and you plotted it on a graph, you'd wind up with a smooth bell curve; there would be no babies weighing 500 pounds to skew it. In physical reality, it would be impossible for a woman to give birth to a 500-pound baby. There are limits to what can happen.”

But if you graphed price-to-earnings ratios of all the stocks in the Standard & Poor's 500 stock index over a 10 year period, you would have to include the black swans—the unpredictable, unthinkable “outliers,” instances of companies with a P/E of 300, or companies with no earnings and an infinite P/E. They would skew your curve. “This is why Long-Term Capital Management blew up,” says Taleb, referring to the Greenwich, Conn., hedge fund that went under in 1998. “They thought they could scientifically measure their risks. They ignored the possibility of a black swan.”

Given the uncertainties of financial markets, both Bernstein and Taleb acknowledge that it is very difficult to say

how much of an investor's success is due to skill, how much to pure luck. Conventional wisdom has it that the record of a star like Peter Lynch is proof that investing is a game of skill, not chance. Lynch did so well, the thinking goes, because he did better and more thorough research than others. But Taleb points out that when we look at investors like Lynch, we're looking at the market's survivors, and he argues it may be sheer luck that certain investors survived while others did not. For instance, a trader may just happen to find herself in the right cycle at the right time. If a bear spent the first 10 years of her investing career in a bear market, shorting stocks, she would look like a genius. If an investor tended to buy on dips and bought U.S. equities from 1992 to 1999, she would appear brilliant.

In retrospect, Taleb says, “we look at traders who have made a lot of money, and we tend to think, ‘they made it because they were good.’ Perhaps we have turned the causality on its head,” he argues. “Maybe we consider them good just because they made money.”

To illustrate his point, he offers a wonderfully ghoulish illustration: Imagine, he says, “an eccentric billionaire who offers you \$10 million to play Russian roulette. He gives you a revolver with six chambers, a bullet in only one chamber, and challenges you to hold it to your head and pull the trigger.” Chances are five in six that you'll come away with \$10 million; chances are one in six that you won't come away at all. In other words, there are six possible paths that your story will take—but after the fact, we'll see only one of them. And, Taleb suggests, if you turn out to be lucky and survive, some journalist might well put you on the cover of a magazine. (“Savvy Risk-Taker Wins \$10 Million.”)

Of course, Taleb concedes, if the roulette-betting fool kept playing, the alternative story line would be likely to catch up with him: “chances are, he wouldn't survive very long.” But, he notes, “when we look at the stock market's stars, we're looking at the survivors from a very large pool of players. Imagine there are thousands of 25-year-olds willing to play Russian roulette, playing each year on their birthdays. At the end of, say, 20 years, we can expect to see a handful of extremely rich survivors—and a very large cemetery.” But that small group of survivors would be hailed as winners—the alternative possibility would be ignored.

Similarly, if thousands of traders are in the market for 20 years, a few are bound to outlast the others, and because they survive, we view them as winners, look up to them, and say they're more talented than other investors. But maybe they were just lucky—after all, someone had to wind up in the

top percentile. Taleb points out that our admiration for these luck-of-the-draw winners is nothing more than survivorship bias. And it applies not only to traders but also to mutual fund managers and to the funds themselves. For instance, let's say that in 1987 there were 30 mutual funds in the United States devoted to investing in technology and that, over the next 15 years, 6 of the 30 produced average returns of more than 12 percent a year, while the other 24 funds didn't last and either were closed or folded into other funds. We would probably look at the six with a 15-year record and say that investing in technology funds is not so very risky: after all, on average, technology funds with a 15-year track record returned 12 percent from 1987 to 2002.

What does all of this mean for the individual investor? First, managing risk involves recognizing that "we don't know what is going to happen—and we have to act as if we don't know," says Bernstein. "This is the theme I think about every day. I know that if I have a choice between more than one possibility, I am likely to be wrong in any choice I make." For that reason, when making a decision, investors must worry, not about the probability that they will lose, but about the size of the risk. Just how steep is the downside?

Because investors tend to focus on the frequency rather than the size of the risk, they pay too much attention to what happens "on average," Taleb adds. "On average," stocks beat bonds—but this does not tell us whether equities will trump bonds over the next 10 years. One has to consider the possibility that they won't. Investing in equities is often a successful strategy, but "it doesn't matter how frequently a strategy succeeds if failure is too costly to bear," Taleb observes. In other words, investors must always ask themselves, "What's the worst thing that can happen, and can I stand it?"

This is why a 55-year-old investor with a nest egg of \$250,000 "would be crazy to put 80 percent of his money into the stock market," says Bernstein. Even if the odds are high that, over the next 10 years, he will make money, "if he's wrong, he's dead." There is always the possibility, however slim, "that bears like Bob Prechter could be right. We could be facing a long bear market that takes the Dow below 1,000. No one knows."

In fact, the black swan could appear tomorrow. The stock that everyone said was a safe haven could blow up. "People tend to think of low probability events as being distant in time," says Bernstein. In other words, we say, "Well, yes, gold went to \$800 an ounce, but that was more than 20 years ago." Or, "Well, yes, in 1980 we had double-digit inflation—that couldn't happen now." But Bernstein is emphatic: "Probability has nothing to do with time." The surprise that would upset the best-laid forecasts could be waiting just around the corner. "When I explain this to people, they nod their heads," says Bernstein, "but it is very difficult to get them to believe it, to act on it."

In part, this is because investors assume that if they just do enough research and have enough information they can protect themselves against surprise. But our information is

always imperfect. "We can assemble big pieces of information and little pieces," says Bernstein, "but we can never get all the pieces together. We never know for sure how good our sample is. The uncertainty is what makes arriving at judgments so difficult and acting on them so risky."

In our efforts to manage risk, we diversify. But diversification is no insurance against disaster—as many investors who bought a wide range of stocks over the past three years have discovered. "Diversification leaves a great deal to chance," Bernstein acknowledges. "It doesn't always work."

What then is an investor to do? This is where Taleb and Bernstein part ways. Taleb suggests that ultimately, for individuals, the stock market may be simply too risky, the randomness too great. This is why he keeps all his own savings in Treasuries. He never buys stocks—not in bull markets, not in bear markets.

As a professional options trader, he does, of course, bet on the market. But he only bets on black swans—the most improbable events. This means he usually loses. It's as if he's at the track and only bets on the horse offering the longest odds. If he makes 1,000 bets on 1,000 races (or 1,000 options trades) he'll probably lose 999 times. But he'll lose small amounts. (He makes many small bets). And when he wins, that one time out of 1,000, he wins big because the odds were so long that the return is huge.

Trading options for more than 15 years, Taleb has managed to survive bull and bear markets. Many traders have a few good years and then "blow up," Taleb explains. "The quality of my profits is higher. I make my living by betting against people who take themselves, and their knowledge, too seriously—people who think they can predict the market. And, because no one thinks that the option I pick will pay off, it is always underpriced." Indeed the stock market may be far less efficient than the racetrack, where the physical limits of horses are more easily measured. At least we know a three-legged horse can't win. But shares of a company without earnings could go to \$500.

In short, as an individual investing for his own account, Taleb's strategy is not to diversify but to stick with the bet where random chance plays almost no part (he is assuming, of course, that the U.S. government couldn't default on its debt). Nor does he try to diversify as a professional, instead betting only on those long shots.

Bernstein takes a different approach. Although "diversification leaves much to chance," he still believes it is the key to risk management: "It is all we have. Like capitalism, you could say, it is the best of bad alternatives." Moreover, precisely because financial markets are so unpredictable, "the best way to manage risk is to be exposed to all the risks. This means investing in different classes of assets, taking on the risks of stocks, bonds, real estate," he adds. Bernstein believes investors should diversify even in areas that make them uneasy: "I once had a partner who said that if you're comfortable with all of your investments, it's a sign you're not sufficiently diversified."

We can assemble big pieces of information and little pieces, “but we can never get all the pieces together. We never know for sure how good our sample is.”

In other words, investors can be too risk-averse: “I had another, older partner who was extremely cautious, as risk-averse as you can get—and he knew it,” Bernstein recalls. “He used to say ‘I’m like a fish that starves to death because whenever I see a worm, I assume there’s a hook in it.’”

Like Taleb, Bernstein views the stock market as a high-risk game, “which is why the 55-year-old with \$250,000 should probably make his major commitment to fixed-income investments. On the other hand, if an investor is very young, I would advise him to shoot for the moon.” But while Bernstein would advise the hypothetical 55-year-old to put the bulk of his savings into investments that guarantee a fixed return, he warns against avoiding stocks altogether. “To be entirely out of the market is also a risk. Stocks can be a hedge against inflation,” he notes. “Each asset class is distinct. Stocks may give you something that nothing else can give you.” This is why he would counsel the older investor to hedge his big bet on fixed income by investing in a variety of other assets.

“And when hedging,” he adds, “you want to get the biggest bang for your buck. Because hedging is always expensive, you want to bet on things where the upside is steepest, so if you win, you’ll win big.” For this reason, he says, “I might well advise that older investor to take a small position in gold—say 5 percent of his portfolio. I also probably would advise him to take a position in Treasury inflation-indexed securities [known as TIPS]. The odds of high inflation seem low right now, but if sustained high inflation suddenly returns, you’ll get a big payoff from TIPS.”

In other words, when it comes to hedging his position, Bernstein, like Taleb, would bet on the black swans. He knows that, even if you can’t see them, they’re there.

Maggie Mahar is the author of Bull! A History of 1982–1999, which will be published by HarperCollins in October.

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6 Do's and 6 Don'ts of a Successful Advisor's Practice

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continued from page 1

Six don'ts

1. Keeping Up with Financial News: Some advisors think they need to know exactly what's happening in the market, the economy, or the world. Although what I'm about to say flies in the face of conventional wisdom, pay close attention—reading financial magazines and listening to financial radio and TV are absolutely useless behaviors for a financial advisor. The time you spend following the news is time when you're not building an intelligent business or taking care of your clients. The only people who need to know what's going on in the market, the economy, and the world are the people who actually manage money. Some advisors get confused. They seem to forget that they're financial advisors, not money managers, insurance experts, accountants, or lawyers.

2. Getting Ready to Get Ready: I've adopted a mantra at my firm: Bill should only do what only Bill can do. If a task is delegable, it should be delegated. A corollary to that rule is that certain things should be done during prime time, and certain things should be done during non-prime time. For example, you definitely need to spend time creating an image for your company. You must be able to communicate and articulate who you are and what you do. The question is, when should you do that? The answer, of course, is during non-prime time. Unfortunately, many advisors would rather spend time working on their company brochure, marketing materials, or Web site than actually asking for and following up on referrals. After all, they can't possibly feel rejected when they're rewriting their promotional literature for the seventeenth time!

3. Becoming Overinformed or Overeducated: Another form of work-avoidance is to be informed and educated beyond what your clients actually need. Some advisors do this by studying for every possible designation in the financial services industry. Others do it by reading books and magazines, listening to tapes, or attending training programs and conference sessions that are incompatible with the systems they've chosen for acquiring clients and running their business. Which leads to a very good question: Do you have a system for acquiring clients and running your business? Since most advisors don't, they frequently go to conventions and sit in on every session. They don't discriminate between what they need and what they don't. Very few advisors attend conferences with pre-planned agendas and then come back with something they can really use. Instead, they come back with pages and pages of notes that they put on a shelf and

instantly forget. Before you sign up for your next course or seminar, ask yourself honestly whether it's the best use of your time or whether you're simply engaging in work-avoidance behavior.

4. Talking About Your Business Instead of Working On It: Many advisors spend a tremendous amount of time talking about what they're going to do, especially during prime time. When I was an advisor, five to eight times an hour, one of the other advisors in my office would walk in to ask me a question or talk about something that was completely irrelevant for prime time. I tried hanging a sign on my door, but that didn't work, so I'd literally barricade my door with my chair in order to get some work done. If I didn't, I'd get interrupted continuously. Prime time is for taking care of existing clients and acquiring new ones. Period.

5. Putting Out Fires: "Fires" are usually situations that your staff should handle. Many advisors don't empower their staff members to solve problems or serve clients. They unconsciously sabotage their own success because complaining about their staff and then doing the staff's work is frequently more comfortable than doing what they're supposed to do, which is asking for and following up on referrals. Managing money, writing financial plans, being a junior wanna-be economist, or doing anything else that could be delegated or outsourced (such as taxes, insurance, legal decisions) are serious work-avoidance behaviors.

6. "Checking In" to See How Clients Are Doing: Except for emergencies, client interaction should occur on a regular schedule. I've heard statistics that the most successful advisors are in contact with their clients 28 times a year. That could happen through 12 monthly statements, 4 (quarterly) face-to-face meetings, and 12 additional scheduled contacts, such as monthly phone appointments, non-financial newsletters, or other written or verbal contacts. Client contact should always be orchestrated; random contact is just another work-avoidance behavior.

Six do's

Now that we've identified the most common work-avoidance behaviors, you're probably wondering how a successful advisor's work day does look. Here are six areas on which they spend the vast majority of their time.

1. Holding Their Clients Accountable: Successful advisors report that their highest priority is to hold their clients accountable for doing what they need to do to achieve their goals. Most client-advisor relationships are backwards. When clients and advisors get together, the conversation

tends to revolve around trying to rationalize things that aren't rational and can't be rationalized, like, "Why did the market do what it did?" and "What do you think the market's going to do in the future?" and "Based on what you think the market's going to do, what do you think we ought to do?" Most advisors waste time answering these questions, but successful advisors tell the truth: "I have no idea, but I do know that if you behave this way—if you invest your money this way over time and stick with this plan—you will achieve your goals." Competent advisors hold their clients accountable to do what needs to be done so goals can be achieved in the face of the truth, which is that we don't know what's going to happen. I often say that the success of what you're currently doing is built on the foundation of what immediately preceded it. When you create the impression that you have access to some magic information about the future, sooner or later you're going to be wrong. If that's the basis for a relationship, your clients will leave when they realize you can't predict the future.

2. Helping New Clients Get Clarity: The most successful advisors spend a considerable amount of time helping potential clients get clarity about what's truly important to them (their core values), helping them define their goals, and benchmarking their current reality so they can make the smart decision to hire the advisor to create and implement a written, comprehensive financial plan. Don't overlook this important step. Remember, you can't help your clients get what they want until you know what they want and the reasons those things are important to them.

3. Harnessing Their Resources: To create a plan that gives clients the highest probability of achieving their goals, successful advisors spend time harnessing their resources. This

includes both the resources at their company and the external relationships they've developed. Their resources might include a plan writer, a money manager, an insurance expert, and several tax and legal experts. Remember, it's your job to build a team of experts who facilitate the delivery of your promise to the clients, which is to help them achieve their goals for the reasons that are important to them.

4. Execute a Referral System: Successful advisors want their appointment calendars to be full, with as little time taken away from serving clients as possible. There are many ways to fill your appointment calendar, and the least expensive, least time-consuming, and most effective way is through referrals. Make sure you have an effective system for obtaining and following up with referrals.

5. Hire a Competent Staff and Keep the "Machine" Running Smoothly: Successful advisors hire competent staff people and hold them accountable to develop and implement effective operational and administrative systems to serve their clients. The size of your staff will depend on how many clients you have and how little you want to work.

6. Write Your Own Financial Plan: You'd be surprised to learn how many advisors neglect this step. They recommend financial plans for their clients, yet they fail to write a plan for themselves. Walk your talk! The most successful advisors take time to write their own financial plans, then they build their businesses so their financial goals are actualized.

Last but not least: Don't be a salesperson, be a Trusted Advisor.

Bill Bachrach is President of Bachrach & Associates, Inc.

Risk: Something to be Controlled, Not Just Accepted

ROGER J. SCHREINER

The period of prosperity that lasted from the early 80s through the 90s was long enough to convince most investors that the stock market is a game of guts – not brains.

WHEN I WAS A YOUNG MAN AND JUST OLD enough to drive, my father occasionally allowed me to use the family car. With his permission I was able to drive to baseball practice, to visit friends and maybe go to the movies on Saturday night. But it wasn't always easy getting permission to use our '57 Chevy.

Each time I asked to use the family car my father would begin his litany of questions; "Where are you going? Are you going directly there and back, or will you be going somewhere else? Who will be in the car with you? Will you be home before dark?"

However, if I left *without* the car, my father didn't ask many questions. I didn't understand why he was so cautious when I was driving and so much less concerned when I was walking or staying in the neighborhood. So I asked, "Why all the questions?"

"When you ask to take the car," he said, "I want to make sure you really *need* it and that you won't be on the road any more than necessary. I want to make sure you're on the road as little as possible because ***the more you drive the greater the chance that you will be involved in an accident.***"

For investors driving down the passive highway in 2000, 2001 and 2002, there were no warning signs. They were blind-sided in a crash that they were not prepared to anticipate. They had become so cavalier about investing that they failed to take any precautions to prevent losses of 40 to 60 percent of their assets.

Broad misconception

The nation's largest investment firms have embraced the philosophy that the stock market, regardless of its short-term fluctuations, will pay off for investors over the long haul. They back up their claim with the long-term evidence that the US stock market was always higher when measured over thirty-year periods. They are confident, regardless of economic fundamentals, technical status, or valuations, when they advise their investors to buy and hold a basket of stocks – that if they hold on long enough, they'll come out ahead.

Their mantra is, the longer you stay invested, the larger your nest egg will be when you finally need it. Many of the nation's largest firms teach their representatives to coach investors to "stay the course" through thick and thin.

One of the main goals for America's largest investment firms has been to convince investors that "the longer they stay invested, the lower their risk." Over the years these firms

have combined to spend billions of dollars in marketing and supporting a passive investment philosophy. And eventually the investing public started believing that the secret to reaching their financial goals was *greater exposure* to stocks. Much to the benefit of the supporters of passive investing, the long bull market (lasting almost two decades) never really did much to contradict their view.

However, Nobel Laureate Paul A. Samuelson stated very clearly almost thirty years ago, "***The longer you own stocks, the greater the risk of a devastating loss.***" Other astute experts in the financial community understand and appreciate that successful investing involves not only the ability to recognize and act upon opportunity, but also the importance of guarding against significant loss. They know that constant exposure to the market without relief puts one at greater risk than necessary.

According to Benoit Mandelbrot, in his fascinating new book *The (Mis)Behavior of Markets*, **the odds of financial ruin in our free global markets have been both grossly underestimated and often misrepresented by investment professionals and investors alike.** Mandelbrot, a professor of mathematics at Yale University, points out a number of heresies in investment finance:

- Markets are very risky.
- Gains and losses are concentrated into small packages of time.
- Prices don't glide – they leap and dive.
- Markets are inherently uncertain.
- Bubbles are inevitable.
- Forecasting prices is likely to be perilous.
- **Value** has its limits.
- Timing matters greatly.

A Titanic example

Low Probability Events can be Life Changing

Even though a collision with an iceberg seems like a low probability event, there are hundreds of floating mines in the oceans of investing. The consequences of collision with an iceberg can be fatal, as it was for the 1,503 passengers on the Titanic. Like the Titanic's Captain Smith, many of us are eager to complete our financial journey. We want, expect, and sometimes even demand extraordinary performance from our investments.

As mature adults, most of us have learned to guard against most of life's low probability events. We insure those

things that are of greatest value to us, like our lives, our homes and our cars. While a car accident or a house fire is a low probability event, it is the kind of catastrophic event that we just can't afford.

However, it's disturbing that even as a relatively sophisticated society, some of us do very little to protect our most important financial possession – our retirement portfolios. Far too many investors continue to accept a passive, buy-and-hold strategy – simply letting the chips fall where they may.

No safety net

Passive investment strategies do not have a backup plan or exit strategy. Those who adopt a passive investment program have no protection against an extended bear market or a catastrophic event. There's no safety net for investors who make a single bet on the US or world markets.

As technology advances and our ability to communicate instantaneously becomes almost commonplace, the periods between market extremes continue to shorten and markets become more volatile. Sophisticated and prudent investors will continue to seek strategies that can avoid exposure to stocks during times of increased risk.

In investing – as in life – one finds only what they seek. Those who don't make the effort to protect their nest egg may end up losing it. Those who look for ways to protect their portfolios will at least have a fighting chance to succeed, even during difficult markets.

We'll continue to fight.

Roger Schreiner is the president of Schreiner Capital Management, Inc. (SCM) and founder of Select Advisors, the nation's largest network of active managers.

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The Move to Paperless

TODD RAPIER

With the exception of 9/11, at no time were the reasons to move to a paperless office more clear than in the wake of hurricane Katrina. Keep in mind there are many ways to protect your business in times of disaster - going paperless is just one way. While the chances are slim that you will ever need to activate a disaster recovery plan and we might not immediately see the cost-benefit of going paperless, perhaps all you need consider is the cost of paper - as illustrated in the following article by Todd Rapier.

— Clint

IN A RECENT SURVEY DONE IN LONDON, MANAGERS questioned stated that on average it takes 15 minutes to retrieve a live hardcopy document and eight hours for an archived file. And what about the time involved in putting the file back? Then there is the cost of file cabinets, rent, paper, toner, etc. Other reports in the U.S. show similar findings with paper management costing businesses one to three per cent of gross revenues per year. Logically, paper-intensive industries are on the high side of those findings, if not higher. Identifying areas in which time and cost efficiency savings could be made is the goal of most paperless offices or, in reality, offices with less paper. However, many do not know where to start, how to implement, or how to comply while going with less paper.

Where to start? First, examine the steps in your office's current workflow. Chart out exactly what happens in your office with your paper-flow. This may seem like a difficult task, but typically you or your office staff knows all the information you need to start out with a simple flowchart. Once your paper-flow is charted out, look for places where technology can help with the paper burden. Keep in mind that there are areas where you may want or need to keep the paper.

Start scanning. The best way to start going paperless is to start. In case you're wondering, that is not a Yogi Berra quote. Once you've identified areas in your workflow where you can use less paper and scan documents, start a pilot project. Buy a couple of desktop scanners and put them to use.. Make sure the scanners are sheet fed, and that they scan at least 20 pages per minute. You may also need some additional software to make this work. Software can run from a couple hundred bucks to several thousand dollars. Be careful of systems that lock you into place by using proprietary databases and proprietary file formats. Another very important piece to remember is that most standard scanning software takes only a picture or image of the document. If the document is misfiled in your electronic filing system, finding the document will be very difficult. To avoid this problem, try to implement scanning software that will generate a text-searchable PDF. This is a combination of an image and hidden text, which can be searched.

Search is important. It is also important to agree on a naming convention for all files. You probably already have this in place with your paper-based system and can replicate this

in an electronic system. Remember, no filing system is perfect whether paper-based or electronic. People break rules, are not aware of rules that are in place, or simply make mistakes. When buying software to manage scanning and electronic documents look for solutions that offer quality full-text search capabilities. Search also helps in finding all documents of a certain type. For example, you may need to find all new client applications for a certain time frame.

Back-up files. When going to less paper and managing electronic files, make certain that you have a high quality backup system in place, if you do not already have one. With the right backup procedures in place and text-searchable documents, a less paper approach can actually be safer than paper-based systems. Paper-based systems are subject to disaster such as fire, flood, and loss. Unless your office makes a redundant copy of each paper-based file, this approach can offer a much higher level of safety for you and your customers. Make sure your backups are stored in a secure location or use a service that backs up your files to an off-site data center automatically. More and smaller companies are going to the second solution as it is less costly and does not require somebody to take a tape out of a drive and put it in a secure location.

Measure ROI. Can you quantify the benefits of using less paper through better access to your information? What is the value of time saved if your office staff can immediately pull up a file versus going to a file cabinet or digging through a paper-based archive? Quantifying ROI requires some analysis, something that should not be unfamiliar to any of you reading this newsletter (at least when it comes to managing money). The analysis on implementation of technology is not much different. Do not let ROI analysis frighten you away from implementation. In measuring technology ROI, be certain to include efforts and costs involved in maintaining traditional workflows, not just those involved in buying new hardware and software. There are also several ROI calculators freely available on the Web and can be found by searching for "technology ROI calculator".

Do not be afraid. Fear and a lack of knowledge about going to less paper seem to be the main reasons why offices do not implement less-paper strategies. Remember, just because you're using paperless office technology, it does not mean your scanner needs to be attached to a shredder. Keep the paper around while you are going through your pilot phase and getting your system "dialed in". Take rational steps toward attaining the ultimate goal of having less paper, offering better service, saving money, and focusing on what you do best.

Todd Rapier is president and co-founder of Authoritative. Net. More information can be found at www.myfilecenter.com or by e-mailing Todd at todd@authoritative.net.

CRAM SESSION – Business Development & Practice Management

October 27 – 28, 2005

Embassy Suites Hotel BWI, Baltimore

THE NEXT CRAM, BUSINESS DEVELOPMENT & Practice Management is shaping up to be one of our best. In an effort to make the most efficient use of time we've carefully chosen an agenda and a location that will allow attendees to focus on the job at hand – streamlining business operations.

Over the two half-day sessions attendees will learn how to:

- Become more innovative and effective in managing back office operations.
- Move toward a “paperless office”.
- Increase assets under management through office streamlining efforts.
- Identify and solve back office problems encountered by your peers.
- Increase office efficiency to accommodate business growth.

As always, the agenda will include what many NAAIM members believe make these sessions so informative – our “signature” Round Tables, where attendees are invited to participate by offering input on the session.

A complete agenda will soon be available online at www.naaim.org, where you can also register. Space is limited to 35 attendees. The cost is \$150. To make hotel reservations at the group rate of \$159 per night, contact Embassy Suites Hotel BWI at 410-850-0747 and ask for the NAAIM group rate. The opening session begins at 1:15 on Thursday, October 27th, preceded by lunch at 12:00.

Dates to Remember

- **Round Table Conference Call: Disaster Plans**
September 28, 2005
Contact Susan Truesdale for a line reservation – naaim@mindspring.com
- **CRAM SESSION: Business Development & Practice Management**
October 27 – 28, 2005
Embassy Suites Hotel BWI
Baltimore, MD
- **Annual Conference**
April 30 – May 3, 2006
Ritz Carlton Phoenix
Phoenix, AZ

If you would like to suggest a topic or a speaker for the conference please contact Susan Truesdale at 303-979-1280 or via email: naaim@mindspring.com.

- **NAAIM Board Meetings**
Held the 2nd Tuesday of each month
11:00 a.m. EDT

If you would like to attend a board meeting, contact Susan Truesdale to receive conference call numbers – naaim@mindspring.com

- **NAAIM Agenda Committee Meetings**
Held the 3rd Tuesday of each month
11:00 a.m. EDT

If you would like to become a member of the Agenda Committee contact John McClure at jmclure@profitscore.com

If you have an article you'd like to contribute, if there's an article you read recently that you think others would benefit from reading, if you would like any of your clients or prospects added to our distribution list, or if there are any specific topics you'd like to see covered in *The Active Manager* please email or call Susan Truesdale at naaim@mindspring.com / 888-261-0787.

New Associate Members

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¹ Source: Lipper, October 14, 2004. Lipper defines "indexed fund" as an open-end mutual fund (not an Exchange Traded Fund, or ETF) that falls into one of the following subcategories: pure index, enhanced index or index-based. The majority of ProFunds are categorized by Lipper as enhanced index funds.