Morgan Stanley

Stock Boy to Stock Broker

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In the more than 33 years I have been advising clients on financial matters, I have seen a lot. Most of what I have learned was from doing it wrong the first time or two. My path to a career as a financial advisor was anything but direct. In college, I managed a game room, hung posters, served beer and checked IDs in the school cafeteria.

I was always pretty good at math but didn't really apply myself until my junior year in college. Since then, I have read as much as possible, sometimes working through five to ten books a month. Along the way, I figured out something really important:

"No one cares how much you know until they know how much you care."

From stock boy to stock broker

I started working at my dad's hardware store when I was eight years old putting price labels on merchandise. I graduated to car loader, stock boy, cashier, and paint salesman. Next I sold Japanese beetle traps door to door. In college, I had jobs during the school year and was a traveling sales person in the summer and sold life insurance, At 22 started cold calling as an Account Executive at Merrill Lynch.

It's always been about solving problems

I remember hearing my dad tell us stock boys to never let a customer leave the store without bringing them to a salesperson (read: experienced adult) even if we didn't have the item in stock. He explained that when a customer came in with ten things to buy they really came in with ten problems to solve. As the saying goes, no one wants to own a drill – they want a hole.

Our job was to help the customer solve ten problems and thereby avoiding forcing them to drive around town to find solutions. In most cases, if our paint brush was a dime more expensive, it didn't matter. It was only later that I understood the enormous value in being able to solve all of your problems in one trip.

In managing wealth, it is the same thing. I don't think people really want to buy stocks or mutual funds, what people really want is to retire comfortably, pay for college, leave their children a nest egg, and if there is still a little more, help the poor and the sick. But first we want our wealth to solve the problem of living our lives.

From broker to advisor

At Merrill Lynch, I started out as a bullpen broker selling municipal bonds to unknown names in a telephone book. From there, I evolved to investment consulting and ultimately to advising clients worth billions. How did that happen?

Having entered the investment business shortly after graduation in 1983, I never went to business school. So I took a page from Abe Lincoln's book and read everything I could. Since then I have read thousands of books, magazines and articles about investing, the investment industry, great investors, and dynastic families.

Books about Peter Lynch, Sir John Templeton, David Dreman, Stan Fisher, and of course Warren Buffett, fill my library, heavily dog-eared and annotated. They sit next to countless textbooks on accounting, understanding financial statements, balance sheets, calculating free cash flows and annual reports. And how could I resist reading about the scandals, tragedies and triumphs of Gould, Rockefeller, Vanderbilt, Guggenheim and the rest of "Our Crowd".

Theory to practice

In the early 80's, as investment consultants, we were immersed in proper asset allocation and portfolio construction. We recommended "efficient portfolios" that "optimized" expected risk and return. We ran "Monte Carlo" simulations and diversified into as many asset classes as we could find. Risk was defined as volatility and volatility was measured by standard deviation.

The Holy Grail was finding the perfect combination of the highest risk-adjusted rate of return. We were in search of managers whose investment performance would always be in the "northwest quadrant", which suggested they would earn results higher than the stock market while at the same time experience lower volatility.

What about the taxable investor?

But a funny thing happened on the way to the forum[1] (please forgive my poor puns, mixed metaphors, and random references). I found that the regular tinkering with tactical allocation, while achieving risk containment, often created unwanted tax liability for taxable accounts.

Now, one must <u>not</u> let the "tax-tail" wag the dog. However, the hallmark of successful investing, for a tax paying individual, in my opinion, is what is accumulated, overtime, net of taxes. Both my clients and I grew tired of writing ever-larger checks at the end of every year.

As a young advisor, I looked at the old codgers (usually men in their 50s or older) and wondered why they recommended blue chip, dividend paying stocks and bonds. When I began consulting to institutional clients, I recommended investing with small cap, mid cap and large cap managers, to complement the international, emerging market, and high-yield bond managers. Maybe buying established, brand-name, dividend paying stocks was all the old brokers knew. Maybe, just maybe, there was more to it.

Cue the light bulb

Let's zoom forward to about ten years ago, 2007. After reading every annual report, management letter and even the original partnership letters, it dawned on me that maybe Warren Buffett's approach, buying great companies and holding them for a long time, might be the way to go.

No one is as good an investor as Warren Buffett, but there are some basic concepts he has clearly outlined in his 50 years of writing that can be replicated. One needs to understand, apply and adhere to his principles.

Believe it or not, this is harder than it sounds. It seems pretty easy to identify great companies looking backward at historical results. It is a lot harder looking forward. It is harder still to know when to buy them, how much to buy, what price to pay, and avoiding the temptation to sell. It is especially hard to hold on to stocks when the market is collapsing and the media is frenetically encouraging everyone to sell.

Do it yourself or outsource?

Most people enjoy being in control when things are going well. Being at the helm is satisfying when there are sunny skies, a light breeze and small waves ahead. However, few people want the responsibility, or blame, when turbulence arises, the future is uncertain and bad decisions can have disastrous effects. Managing your family's fortune is a big responsibility; especially should things go poorly for several years.

Charlie Munger gave an interview in 2009 and said he and Warren Buffett had seen their net worth cut in half three times since they partnered up in the late 60's. No one wants that, which is why I think almost all investors should have bonds and cash set aside for these inevitable down drafts, and should outsource the investment responsibilities to an experienced professional.

If you are going to invest

The investment discipline in selecting individual companies, it seemed to me, was to focus on the key elements of the company's operations, not the stock price. If the company had a strong balance sheet, diverse revenue sources, a history of solid return on capital, growing earnings and dividends, it should weather poor economic cycles and do just fine when things turned around.

Of course, things go wrong, mistakes are made, technology disrupts and competitive threats arise. So one needs to be conservative and when the disruption occurs, determine if it appears temporary or transformative, and assess how the company management deals with it.

Cue the second light bulb

More and more as I evaluate investments, in addition to the financial details, I factor in human emotion and behavior. The things that drive our basic survival instincts can also impact investments, society and life. Put differently, human nature hasn't changed much over the last 5000 years. So now, one thing I look for, is whether or not something has to change to succeed.

If you rely on things changing, you can buy distressed assets or high growth companies. Both strategies will work when correctly executed, but both rely on something changing that most people don't expect.

Most people don't like change

The other way is to recognize most people don't like change and prefer as little as possible. In that case, you might want to own companies that produce products and services that people have liked for decades and hope the consumer doesn't change their behavior.

For the first twenty years I followed the former, relying on change. The last ten years I have adopted the latter. If I can find great companies that keep on being great companies, it is a lot easier. Some companies will fizzle out but, like the laws of physics, when an object is in motion, it tends to stay in motion until acted upon by an external force. So I prefer to recommend stock in companies that people have patronized for a long time and are likely to continue to do so in the future.

Did you beat the index?

To me, the most important question is not whether your performance in any given year beat an index; it is whether you are on track to achieve your goals. I am very pleased if, in aggregate, the companies I own maintain or expand their competitive positions, retain strong financial fundamentals, grow their earnings and dividends and keep their customers happy. If my cash flow, after-tax, goes up in excess of inflation, I am thrilled. Beating an index, to me, is not the point.

Investment goals and objectives

Goals and objectives can be expressed different ways. For a long time, as consultants, we had individuals adopt investment policies that were modeled after the requirements of the ERISA Act of 1974.[2]*."*

Today I recommend to clients like myself to invest for a rate of growth in excess of inflation after I pay taxes and fees. I encourage clients to be less concerned if the price of their assets goes up or down as much as a popular index. If the operations of the companies are performing well, the odds are pretty high I will recommend keeping them, regardless of price fluctuation.

From advisor to advocate

Today I advise clients on family governance issues, structuring options, charitable aspirations, and their entire balance sheet. In my experience, the role that is most desired by clients is one of a senior strategic advisor who helps bring the family's macro goals into tactical implementation. Whatever that role is called in the future, it will always be about solving problems.

Why I write

For as long as I can remember, I have wanted to layout a simple step-by-step guide that regular people could follow to understand how to manage their financial affairs. I hope this helps you find the best way for you and your family.

So there you have it: how I got to where I am today, as an investor and financial advisor. We all have a story and it is up to us to write the final chapters. What's yours?

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[1] *A Funny Thing Happened on the Way to the Forum", Stephen Sondheim, Burt Shevelove and Larry Gelbart*
2 CFA Institute, *"Elements of an Investment Policy Statement for Individual Investors"*, May 2010 | Vol. 2010 | No. 12