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The Smarter Investor

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A Radical Proposal for Investors

What if investors had an independent second opinion?



Loss aversion and confirmation bias hurt our decision-making abilities.

By [Daniel Solin](#) | March 18, 2015 | 9:27 a.m. EDT



I have a radical proposal for you to consider. Stop making investment decisions for yourself. Here's why:

You aren't good at it. A number of studies demonstrate that most people are terrible at [making investment decisions](#). Data from Richard Bernstein Advisors showed that, for the period from Dec. 31, 1993 through Dec. 31, 2013, the average investor had an annualized return of about 2.2 percent. A study from Nuveen Asset Management examined 20-year annualized returns by asset class for the period from 1992 through 2011. The average investor had returns of only 2.1 percent during this period.

You're not prepared for retirement. According to the Employee Benefit Research Institute, employee savings remain low, and only a minority of workers are taking basic steps to prepare for their retirement. A majority of employees and 44 percent of retirees are concerned about their level of debt. In addition, a deeply troubling study by the National Bureau of Economic Research, found 50 percent of Americans would struggle to come up with \$2,000 to deal with an [unanticipated financial emergency](#).

You follow bad advice. Despite overwhelming evidence to the contrary, most investors rely on

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brokers who say they can "beat the market" by picking stocks, by identifying when to get in and out of the market and by selecting outperforming mutual funds. While there is an encouraging trend toward index-based investing, even the most optimistic predictions indicate most investors will continue to chase the elusive dream of "alpha."

If so, the current mechanism of wealth transfer, where money moves from your pocket into the pockets of the people who "manage" it, is likely to continue. There has been talk of a "retirement tsunami" for some time. For many, it has become a reality.

Why you need a new decision model. There is a [wealth of evidence](#) indicating that people are better at making decisions for others than they are at making those same decisions for themselves. The co-author of one such study, released last year, "Exploring Solomon's Paradox," Igor Grossmann, summarized his findings in an Association for Psychological Science press release: "We are the first to demonstrate that there is a simple way to eliminate this bias in reasoning by talking about ourselves in the third person and using our name when reflecting on a relationship conflict. When we employ this strategy, we are more likely to think wisely about an issue."

Daniel Kahneman, a Nobel laureate, has a number of explanations for why we are so bad at decisionmaking. At the core of Kahneman's research is the conclusion that our decisions are often not "anchored in reasons," according to a 2014 Guardian Liberty Voice article. We are inclined to make decisions irrationally, based on "cognitive biases." These biases range from "confirmation bias," where we screen out information contrary to a pre-existing belief, to "loss aversion," where we place undue emphasis on the possibility of loss over the potential for gain.

Other explanations for why we make poor decisions include having a closed mind, only focusing on one variable and making choices too quickly. Many people believe that recognizing these issues is sufficient to solve the problem. A Lifehack article by Douglas Rice, for example, gave the following advice to those who want to make better decisions: "Doubt your intuitions. Test your assumptions. Seek a wider range of possibilities."

For whatever reason, individual investors make awful decisions and are likely to continue doing so.

My radical proposal. The financial services industry is clearly one undergoing a major transformation. Sophisticated technology is making pure investment advice, especially for those with modest assets, more of a commodity than a service. In a perfect world, investors would rely exclusively on registered investment advisors (RIAs) who have a [fiduciary duty](#) to place the interest of the investor above their own. The only RIAs that investors retain would be those whose investment advice is "evidence-based," meaning that it is supported in peer-reviewed financial journals.

Unfortunately, we don't live in a perfect world. Investors, it seems, will continue to rely on financial planners who have a lower standard of duty and whose advice is both conflicted and contrary to the weight of academic support.

To surmount these formidable obstacles, I propose introducing a new disruption to the financial services industry. It involves the creation of advisory firms whose sole purpose is to give a second opinion on the portfolios of their clients. These firms would charge an hourly or project fee. They would be contractually prohibited from converting the consulting arrangement into an advisory one. Their advice would be totally independent. They would offer no other products or services.

After the initial consultation, these firms would be available on an hourly basis for "one off" advice meant to assist clients being offered new financial services or products. This model is already readily available in the medical community, and it is frequently required by insurance companies before they authorize expensive surgery. The need for [independent, non-conflicted advice](#) in the financial services industry is even more compelling. Investors suffer from an overabundance of misplaced confidence.

Perhaps it's time to recognize you would be better off if you didn't make your own investment decisions. It may also time for potential disruptors to seize the opportunity to create the infrastructure that will satisfy the needs of this new market. Everyone will be a winner.

Dan Solin is the director of investor advocacy for the [BAM ALLIANCE](#) and a wealth advisor with Buckingham. He is a New York Times best-selling author of the *Smartest* series of books. His latest book is "The Smartest Sales Book You'll Ever Read."

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