RIA Reads: CNBC’s miss highlights planners’ challenge / Begging the gold question

Welcome to RIA Reads, a weekly newsletter for advisors and everyone else in the RIA industry

CNBC is out with its ‘FA 100,’ in which ‘CNBC ranks the top-rated financial advisory firms of 2020.’ (‘Top-rated’ by whom? CNBC, it would appear.)

After ranking the rated, CNBC progresses to celebrating:

The CNBC FA 100 celebrates those advisory firms that top the list when it comes to offering comprehensive planning and financial services to help clients navigate their financial lives. The advisors at these firms assist in setting realistic financial and personal goals. And they will help a client stay on track to meet changing goals due to personal circumstances, and any life-changing events.

Weighing in at number one is Salem Investment Counselors, and rounding out the top five are Dana Investment Advisors, NewSouth Capital Management, Montag & Caldwell, and Brandes Investment Partners.
There’s just one problem: none of the firms ranked two through five provide financial planning, according to their Form ADV filings. Dana Investment Advisors holds itself out as an ‘Asset Management firm,’ that mostly invests on behalf of corporations, government entities and charities. NewSouth is a predominantly institutional asset manager that manages four heavily concentrated value-centric portfolios. Montag & Caldwell describes themselves as ‘long-term investors focusing on high quality growth opportunities.’ Brandes is a Benjamin Graham-obsessed value investing firm that counts RIAs among its clients, which means it is at least one degree removed from any financial planning.

Also in this list’s top 20 financial advisors? Fixed income asset manager Agincourt Capital Management; SOL Capital Management, which promises ‘Serenity for Complex Wealth Needs’ and charges a 1% AUM fee on the first $5m but feels it necessary to disclose that ‘Neither SOL Capital, nor any of its representatives, serves as an attorney, accountant, insurance agent, or financial planner and no portion of SOL Capital’s services should be construed as such’; and Woodley Farra, who call themselves ‘Your Financial Coaches,’ tell potential clients that ‘We’d love to sit down and discuss your current investment strategy and long-term goals,’ and charge 1.25% on the first $500k – but do not provide financial planning either, instead focusing solely on investing.

What the hell is going on here?

Well, it seems that the list’s methodology (which examines ‘Disclosures,’ measures of size, and various ratios) is simply out of step with the project’s stated value:

If you’re one of the many people who do not yet work with a financial professional, taking the right steps now can offer you some peace of mind for what happens down the road. To that point, you may want to work with a financial expert to help you stress-test your retirement plan or build up emergency savings for unforeseen expenses.

This mismatch is innocent if the listed firm is, say, managing institutional bond portfolios. But it’s a real problem when the company is providing services that are in fact adjacent to financial planning.

How many clients will turn up at the digital doors of these companies, ready to fork over 1% in order to receive a set of services that will never be provided to them? By using language like ‘serenity,’ ‘coaches’ and ‘goals,’ some of these
firms are clothing themselves in the pleasant-looking garments of financial planning, while in fact fulfilling the same purpose as a far cheaper robo-advisor or target-date fund. And by putting these firms on a list of top financial advisors that touts the value of financial planning, CNBC is making it harder for potential clients to understand what they’re actually getting for that annual 1% vig.

Now, listen. I’ll be the first one to tell you that these kinds of lists are hard to design well, that it’s hard to vet every firm, etc. On a personal note, I started my career at CNBC, and I know that it’s full of smart and well-meaning people. Though actually this fact — combined with the absence of a specific byline on the list article, and the fact that the follow-up pieces were written by a freelancer rather than by one of CNBC’s able personal finance reporters — only make me wonder whether there’s something rotten in Denmark.

The takeaway for advisors who actually do engage in financial planning? The media, like the regulatory bodies, are not particularly interested in drawing bright lines around Firms That Do This and Firms That Do That. Maybe clients know they want a fee-only firm — but have no idea what that fee is supposed to pay for. Focusing on holistic planning is dandy, but unless you can show people what that actually means, they’ll associate you with high-cost money management shops, and your potential clients’ friends will ask them, ‘Why not just use ETFs instead?’

It’s time for the planning industry to provide a strong, simple, and verifiable answer to that increasingly relevant question.

**The golden puzzle**

Gold is hard to value, though this understates the case considerably; it is a challenge to get everyone to agree that gold actually can be valued.

For a long time, it was the US dollar (and other currencies current and ancient) that were priced based on gold, rather than vice versa. This idea lives on in the occasionally voiced belief that gold prices are a direct (rather than indirect) indicator of inflation — a framework which renders absurd the question of whether gold is expensive or cheap, since it is in fact the dollar itself that would be getting cheaper or more expensive.

Economic-theory battles aside, gold doesn’t fit into any of the dominant valuation frameworks since it doesn’t produce profits or dividends. This describes other commodities as well, but valuing gold is particularly strange
since a large proportion of its demand comes from other investors. This makes it a bit of a greater fool asset; it’s worth now what someone else will pay later.

As a result, investors may choose to buy gold without performing valuation work at all, reasoning that it should provide diversification in a variety of environments, or supposing that if inflation rises, gold is likely to rise as well. Others may rely on baroque, alternative metrics – such as the idea, oft–cited by my grandfather, that an ounce of gold should cost about as much as a well–made men’s suit.

Claude Erb, Campbell Harvey, and Tadas Viskanta combine some of these approaches in a just–released paper, published by the CFA Institute’s Financial Analysts Journal, entitled ‘Gold, the Golden Constant, and Déjà Vu.’ Here’s what they came up with:

Just as it is possible to think of a stock’s price as the product of its earnings and its price–to–earnings ratio (P/E), it is possible to see the price of gold as the product of an inflation index and the real price of gold.

More specifically, their framework suggests that the two primary ‘return drivers’ of the gold price are the rate of inflation and the ‘real’ (that is, inflation–adjusted) price of gold.

If this sounds reasonable, you might be missing something. The gold price would appear to be forecasting itself. The authors write: ‘What happens to the price of gold over the next decade will largely be determined by what happens to the real price of gold,’ which veers dangerously close to tautology.

The authors use their methodology to support the following warning:

Currently, the real, or inflation–adjusted, price of gold is almost as high as it was in January 1980 and August 2011... Today’s high real price of gold suggests that gold is an expensive inflation hedge with a low prospective real return.

But forecasting the gold price based on prior inflation kind of misses the point. The reason so many are now interested in gold is that they expect inflation in the future to surpass the very low levels of inflation that we have seen recently.
The authors acknowledge this, writing that in 1980 and 2011, ‘high real gold prices coincided with widely held views that future inflation would be significant.’ They add that ‘Those widely held views were ultimately proved wrong’ – or, put differently, ‘In the past, movement in the price of gold has been a useless predictor of future inflation.’

While their methods may be unorthodox, I do agree with Erb, Harvey and Viskanta in their conclusion that continued low inflation would likely prove harmful to gold price returns. But is that really news to the hordes of investors who are currently buying gold since they worry (or hope) that inflation will soon rise?

Quick clicks

- What a Delay in Stimulus Means for the US Labor Market (DataTrek Research)
- Disney urged to axe dividend and double streaming budget (Financial Times)
- Preparing for the Future of Parking (Parking Today)

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