Transcript Details

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Applying the Evidence-Based Paradigm to Investing

Announcer Introduction

You're listening to REACHMD. Welcome to our feature on "**Applying the Evidence-Based Paradigm to Investing**," brought to you by TGS Financial Advisors, the wealth management firm that is committed to improving the lifetime financial outcomes for physicians and their families. Here is your host, Dr. John Russell.

Dr. Russell:

Today we're going to talk about why the evidence-based paradigm for medicine can also apply to investing and how that can improve financial outcomes. Joining me today is Jim Hemphill. Jim has been a Certified Financial Planner professional since 1982. He received a Certified Investment Management Analyst designation after study at the Wharton School of Business. He is cofounder of TGS Financial Advisors and also serves the firm as Managing Director and Chief Investment Strategist. Jim is a graduate of Swarthmore College, and he specializes in complex wealth transfer and retirement transition strategies.

Jim, welcome to the program.

Mr. Hemphill:

Thank you. It's great to be here and great to see you again.

Dr. Russell:

Good to see you again. So, your firm follows an evidence-based investment plan for your clients. Can you expand upon that a little bit for me?

Mr. Hemphill:

Yes, so first of all, it's not something that we made up. It's a term of art that has really emerged in the last five or ten years, and it is associated primarily with Gene Fama of University of Chicago, who won the Nobel Prize for economics two years ago for his concept of efficient markets. And what the term really means is, let's look at what the evidence says about what works and not at sort of the anecdote or the advertising or all of the Wall Street noise, so let's really follow the evidence.

Dr. Russell:

Yes, and certainly, I think that's what we do in medicine.

Mr. Hemphill:

Yes, yes.

Dr. Russell:

That's best practices evidence-based thing and not, well, this just seems right. So, how do you go about doing things like that?

Mr. Hemphill:

Well, we want to get ahead, right? What does the evidence tell us about investing? And just go back to the very basics. So, if we go back to the period when we start getting good usable data, which is 1871, and we go through the present and we look at the returns from

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gold, cash, treasury bills, long-term bonds and stocks, and we adjust it for inflation to take out the fact that the dollar has gone down so sharply in value, and what we find is if put a dollar in gold back in 1871, it's worth a couple of dollars now. If you put a dollar in cash, it's worth $6 or $7. A dollar in bonds, it's worth 10 or 12. A dollar in stocks, it's worth over $10,000, $1 worth over 10,000. So, the first piece of data, the first piece of evidence is, historically, stocks have higher returns. Academics call that the equity risk premium, the additional premium for owning stocks.

Dr. Russell:

Sure.

Mr. Hemphill:

Second piece of evidence, value stocks over long periods of time outperform growth stocks. Now, that doesn't mean every day, every year, even every decade. But, over long periods of time, historically, boring companies trading at lower prices have delivered higher economic returns than great growing companies trading at high prices.

Dr. Russell:

Tortoise and the hare.

Mr. Hemphill:

Tortoise and the hare, but also just it really is the case that superior companies underperform because people overpay. Next thing is smaller companies outperform larger companies. And then the final piece of evidence, which has really emerged and been confirmed over the last ten years or so, probably less than that, is that all other things being equal, more-profitable companies outperform less-profitable companies. That effect is smaller than any of the others, than the equity premium, the value or the small company advantage.

Dr. Russell:

If you're just tuning in, I'm Dr. John Russell, and today we're talking about applying the evidence-based paradigm to investing with guest Jim Hemphill from TGS Financial Advisors.

So, Jim, if an investor is not chasing performance, what should they be pursuing?

Mr. Hemphill:

Yes, so, how do we turn this practically into strategy, because that's really what we're concerned about? So, the first thing, as you just said is, first rule is don't chase performance; don't try to outperform the market; just give up the idea that you're going to beat the market. So, instead just say, "My job as an investor is to capture the returns of the market, not to get something extra, just to capture the returns, that will get me where I want to go." So, don't beat the market, capture the returns. Third is the equity risk premium. Have the core of your long-term portfolio in stocks. And a really good way to do that is simply buy and S&P 500 Index Fund, so buy something that is cheap, something that duplicates the performance of the market, capture the return. Next is diversify, and something that is hard to do right now during a period when US markets are performing better than other markets. You really need to diversify globally. It really is a global market, and that diversification, the numbers show, is the most effective. And once you have done all that, you want to really pay attention to costs. You want to try and drive down costs and really pay attention to tax efficiency as well. And if you do those things, just those things, you're going to outperform 80 to 90% of all of your peers. And notice we've only really gotten into one of those evidence-based dimensions, which is the equity dimension. You're going to do really well compared to your peers even if you don't get into the value or the small company or the profitability dimensions.

Dr. Russell:

So, how would you apply that if I'm 35 versus I'm 55?

Mr. Hemphill:

Well, that's a great question. So, if you're 35, the first thing to understand is you want the market to go down. If you're 35 years old, you are going to be a buyer for the next, give or take, 30 years. What do buyers want? Buyers want lower prices.

Dr. Russell:

More for my money.

Mr. Hemphill:

Correct. And then that's true if you're buying tuna fish or if you're buying stocks, if you're buying the S&P 500. If you're 55, you still

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probably have ten years to save, you still want lower prices, but you want to be thinking about the balance of risk, and you really want to be thinking about where do I need to be in terms of accumulation in order to have a cash flow that I need as I gradually transition into retirement.

Dr. Russell:

So, how would I practically go about doing this? So, we started talking about me participating in funds, diversifying. So, how do I go about doing this?

Mr. Hemphill:

So, you can do this yourself, or you can do this with an advisor. I think, in general -- and look who's saying this; I'm an advisor -- but I think in general it helps to have an advisor because you want to have the metrics. And especially at times when the market is doing this and there's an enormous amount of noise, you want to really have a mechanism to bring you back to the signal. If you're following good practice, the signal is your savings rate. It isn't your net worth. So, you want to find an advisor who can report to you on your savings rate very understandably, very consistently.

Dr. Russell:

So, Jim, I think for your listeners, I think the big question is: How do I find that person who is going to help me navigate this landscape? What's the best way for a physician to find a good financial advisor who uses evidence-based practices?

Mr. Hemphill:

So, usually you're going to want to work with a referral from somebody that you know, and then when you get into the conversation, it's really an interview, it's a mutual interview, if you will, and you want to ask them, “What is your investment process?” There are different ways to skin the cat, but what you want to listen for in that process is that it really is a process. It's not an anecdote. It's not a story about what's hot right now or I bought this stock for Joe. It would be great if in the interview you heard the names Eugene Fama or Robert Shiller, because then you know that they are aware of what the best evidence about investing is.

You're really trying to see is this somebody who is guided in their practice by the data or somebody who is trying to market the idea that they're beating the market and they're going to get you extra free money? Realistically, if you look at it, the evidence does not support the idea that that is something that you're going to do, and so you want to stay with somebody who's following the evidence.

Dr. Russell:

And you shouldn't be afraid to kind of move on and find someone else who's right.

Mr. Hemphill:

Correct. And it really is a fit issue. You want somebody that you are going to be comfortable with when the wheels fall off, because our experience as investors is, you know, the market goes down historically 10% about every year and a half, goes down 20% every three to five years, goes down 30% or more twice a decade, and if it's unlucky enough to be the last decade, it goes down 40% and then it goes down 60%, so you need to have somebody that you're going to have confidence in

Dr. Russell:

So, what should I expect that this person I hire as my financial advisor would be doing for me?

Mr. Hemphill:

They are going to be keeping you on track, they are going to be implementing best practice investing, and they are going to be psychologically reflecting back the affirmation of doing the right things. Doctors are competitive. Doctors keep score. Everybody took the MCATs.

Dr. Russell:

Sure.

Mr. Hemphill:

So, you want somebody who's going to say to you, “Hey, you have done a great thing. You have saved this much money last year, puts you ahead of 80% of your peers. That’s what’s going to make you successful. You’ve done a really great thing.” We all want affirmation.

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Dr. Russell:

I think sometimes if we are going to work with someone, we need to have a little bit of trust to work with them.

Mr. Hemphill:

There needs to be, you need to have enough rational information from them that you can delegate with confidence. So, you don't just turn it over. You need the information that they know what they're doing, and you need the open communication, but you need to have the realistic expectations. And then, ultimately, you do need… I believe you're going to get better results if you delegate.

Dr. Russell:

So, Jim, in wrapping up, applying evidence-based practices to investing for a physician, what would be the one point you'd want them to take away?

Mr. Hemphill:

So, what I would say is the elements of investment success are well understood. There are elements of return that historically have been durable. You want to save enough money for long enough. You want to have the core of your portfolio in stocks. You want to capture returns instead of trying to beat the market. And you want to pay attention to costs and tax effects. And if you do that and you start early, you have every expectation, no matter how volatile the markets are, no matter how uncertain things appear, that you're going to be financially successful over time. It sounds like a simple prescription, but psychologically it can be tough, but it works. It really does work.

Dr. Russell:

Sometimes in medicine the most simple prescriptions are the ones that work the best.

Mr. Hemphill:

Yes.

Dr. Russell:

So, thank you so much for being with me today.

Mr. Hemphill:

My pleasure. I've really enjoyed it. Thank you.

Announcer Close

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