Bubble trouble
Dealing with clients fixated on the next sure thing

By Nancy Opiela

Technology stocks are the poster child for bubble investing, but if you've been a planner long enough, real estate, gold, Japan, and now, real estate again, make a fine substitute. What can you do when the "next sure thing" attracts your client's attention?

David A. Twibell, J.D., has had some recent brushes with the real estate bandwagon. As director of wealth management for Colorado Capital Bank, in Colorado Springs, Colo., he sees people who want private real estate investments, high-risk ventures rehabbing houses, even self-directed IRAs so they can invest in real estate with their retirement savings. However Twibell views the current real estate market as a risky place, too late in the game for newcomers. And while he has not lost any clients over his lack of enthusiasm, he has lost prospects.

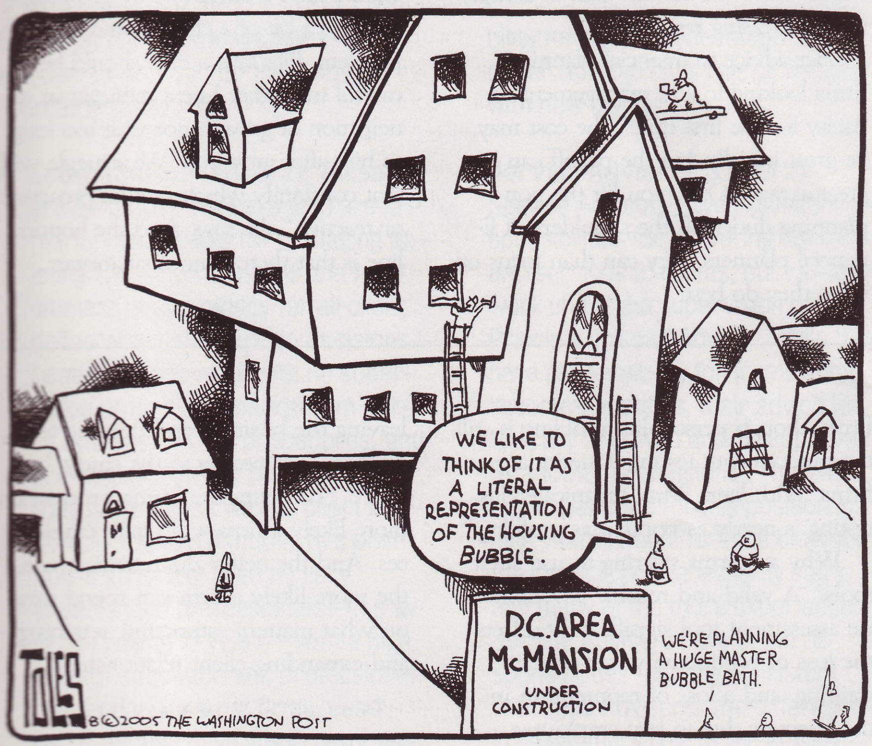
How can you best communicate the distinction between speculation and investing when—as New Yorker John Deyeso, with Financial Filosophy, says—a "bubble is not considered a bubble until after it pops"?

Respond with reason; return to the plan

Marc C. Thomas, CFP®, with Lesjak Planning Corporation, recently had a client ask to liquidate a large portion of her investment portfolio to invest in rentals properties. "She wanted to be in real estate simply because her friends were investing there and she was hoping to earn a higher rate of return," explains Thomas, based in Westlake, Ohio. "I stressed that our philosophy has never been about returns, but rather about achieving goals set forth in the financial plan. We met and revisited her most recent plan to illustrate we were ahead of where we planned and that she was in a very good position. This helped ease her mind that she might be missing out on something. She decided to keep things as they were."

Deyeso, too, favors a quiet conversation about a client's personal goals in order move their thinking from the emotional into the rational realm. "Take the client back to his or her story," he advises. "Why are you here? What are your goals? What is money going to do for your life? The real question is: How can your money help you to live the life you want to live? Should clients own 20 percent real estate? If that's who they are, fine, but let's not invest just because they read about it in yesterday's newspaper."

Also, because the pull of neighbors and co-workers is so strong, Carolyn S. Bishop, CFP®, with Partnervest Financial Group LLC, addresses the importance of avoiding group thinking, in addition to reviewing long-term objectives and risk in her initial client meetings at her Oxnard, Calif., office. She offers a compromise when the client insists on joining the crowd. "We set aside some speculative/aggressive growth money if a client is so inclined. It's usually 1 to 5 percent of the portfolio and if we exceed that percentage, we trim it back."



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Open door or open mind

But what happens when 5 percent isn't enough for a client? At what point can investment views be so opposite that clients are shown the door? Drastic showdowns like those seem to happen infrequently, with many planners working to meet clients halfway.

"I have to accept that it's the clients' money," says Twibell. "If they truly want to have a high-risk investment and understand the possible downside, my job isn't to dissuade them, but to try to make the investment work for them."

To mitigate risk, Twibell might suggest a fund of funds over one hedge fund, or an investment in the pharmaceutical sector or an Exchange Traded Fund rather than in one drug company.

"Clients pay me to give me the best advice I can," he continues. "If they don't want my advice, I can either get rid of the relationship, or try to rein them in as much as I can. I try to let clients make their own decisions, but protect them as much as I can."

There is a strict business component to Twibell's approach: clients sign a disclaimer noting they understand the risks.

Deyeso insists on a separate client meeting to discuss an investment he thinks is the wrong move. "If we're talking about a departure from the investment policy statement, I tell the client to come in and we'll reassess everything," he explains. "That underscores the seriousness of the departure. If they come in and redo their goals and asset allocation, then that's the way they have to go. It's their life." He too insists on a signed disclaimer noting his advice against the investment move.

Sometimes, however, the gulf between traditional and non-traditional is too wide to bridge or the client pushes the planner too far out of his or her comfort zone. In the summer of 2000, two clients of Dave Demming, CFP®, left Demming Financial Services Corp, in Aurora, Ohio, because the firm was not exciting enough for their blood.

"Clients don't pay us to tell them what's popular, but to give them guidance on what we think is appropriate," Demming said. He recalls that after switching to an adviser who had promised to do whatever they wanted, 18 months later the client called to see if Demming would take them back. "Today they are a much more penitent pair on our client list," he says. "If you get through a bubble cycle with someone, you have a client for life."

Bubble mania works both ways

It's not just about the push to invest money in the hottest trend that's problematic, but refusing to take gains off table, says Don Roork, CFP®, with AssetDynamics in Toledo, Ohio. "I have clients who purchased a Florida condo two years ago for $130,000 that is now worth $310,000. They are pulling out 9 percent from their $280,000 IRA nest egg to live, and I've told them repeatedly that we're in a low equity-return environment and that we need them to reduce their withdrawals. Because Florida real estate is clearly in a bubble, another option is to sell the Florida condo, take the $180,000 profit, and rent for a few years until the bubble breaks. Adding the $180k to their portfolio would solidify their retirement income, but they like the Florida condo and don't want to sell it."

The first question to a client is "Why do you own it?," says Deyeso. "Maybe the client doesn't consider the home an investment. I didn't buy my apartment in New York City as an investment; I bought it so I could live in the city. The true value has nothing to do with money, so it's off my balance sheet. Often if you insist that a client sell a home, the response is, 'You don't know me. I'll find someone who does.'"

While these planners offer advice on dealing with bubble investing, you can also share with clients a simple rule of living: Don't worry about what everyone else is doing. And, when clients make a mistake, help them to learn from it.

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***Investment Madness: How Psychology Affects Your Investing... And What To Do About It,* by John Nofsinger (Pearson Education, 2001)**

***The Psychology of Investing,* by John Nofsinger (Prentice Hall, Second Edition, 2004).**

Research from the Bank Credit Analyst "is widely respected and normally gets the big picture right," says Don Roork, CFP®.
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