OPINION

The bolder an adviser’s predictions, the more cautious prospective investors should be

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Certainty-loving humans embrace firm predictions. “Give me a one-handed economist,” was a saying former U.S. president Harry Truman was known for – complaining that “all my economists say, ‘on the one hand … on the other.’” People favour simplicity over complexity, and certainty over the unknown.

Yet, only by incorporating these two elements – complexity and uncertainty – are predictions more likely to come true.

Daniel Gardner, the author of Future Babble, analyzes the research of Philip Tetlock, a psychologist from the University of California. In 1984, Mr. Tetlock recruited 284 experts including political scientists, economists and journalists. Over the next two decades, he asked these experts to predict political and economic trends. By 2003, Mr. Tetlock had 82,361 forecasts.

It was the biggest exercise of its kind and the results were startlingly clear: In Mr. Gardner’s words, as a group, these experts would have been beaten by “a dart-throwing chimpanzee.” The experts collectively did not make predictions any more accurately than informed non-experts.

However, among these experts was a wide range of abilities. “Some experts are so out of touch with reality, they’re borderline delusional," Mr. Gardner observed. "Other experts are only slightly out of touch. A few experts are surprisingly nuanced and well-calibrated.” He concludes: “How one thinks matters much more than what one thinks.”

Experts with a poor rate of predicting outcomes (who would have been better flipping a coin) were uncomfortable with complexity and uncertainty. In Mr. Gardner’s words, they sought to “reduce the problem to some core theoretical theme.” These experts were confident in their predictions. And why wouldn’t they be? They were sure their "One Big Idea" was right, and so the predictions they made must be airtight, too. Mr. Gardener called these thinkers "hedgehogs."

By comparison, experts whose predictive success rates were high thought differently. Rather than reducing problems to a single theory, they drew information from multiple sources and synthesized it. They were self-critical and questioned whether what they believed to be true was, indeed, really true. When they were shown that they had made mistakes, they didn't try to evade the fact. The author calls these thinkers "foxes."

Our financial investment firm is acutely aware of the public's vulnerability to bold predictions. In fact, the whole industry knows exuding confidence increases clients' comfort level. So it's worth it for prospective investors to be self-aware of their need for certainty. The bolder an adviser's predictions, the more cautious prospective investors should be. You are looking for a "fox," not a "hedgehog." Mr. Gardner demonstrates the science behind the paradox: Confident predictions are more often wrong; complex and considered predictions are often right.

When considering a new financial adviser, ask what kind of volatility you should expect from the strategy they are recommending. Be clear – you want after-fee annual, four-year and 10-year volatility estimates. While your circumstances may not result in a balanced approach, ask how their "balanced strategy" has performed after all fees over the past year, four years and 10 years. This allows you to judge managers after fees and using the same risk profile. Ask the prospective adviser to show you a database of balanced-fund historical results. You can be sure the adviser is aware of these numbers.

Once you know these numbers, you can make an informed decision: Does your long-term financial plan incorporate that volatility and sustainable future after-fee returns, while still delivering the planned long-term results?

There is no way to know immediately whether you can trust an adviser. It takes at least three years and one bad market to know whether you are a match. However, if the adviser helps you develop a financial plan, then converts that plan into an investment portfolio with expected after-fee returns and volatility, and agrees to send you regular (quarterly is frequent enough) transparent statements, and to meet with you annually – then you are in a good place.

Sometimes prospects don't realize they are being interviewed, too. Advisers don't want unrealistic clients who won't engage in the discipline required to be a successful client. We want to add value to clients for decades and to do that it must be a trusting partnership. A portfolio delivering against your plan needs to be a mutual plan and it takes years to agree this is happening.

Leslie Cliff is a founding partner of Genus Capital, an independent investment management firm that's celebrating its 30th anniversary this year.