

## **INTERVIEW WITH PATRICK GEDDES**

MATT

Say your name and spell it for me.

PATRICK

Patrick Geddes G E D D E S

MATT

And your title and the name of your firm

PATRICK

Chief Investment Officer, Aperio Group

MATT

Aperio is interesting to me, what does 'Aperio' mean?

PATRICK

'Aperio' is the Latin, it's a verb, it means "to make clear, to reveal the truth" and we wanted that kind of name for this firm, the financial services world, that's an industry that's a little short on people making clear for custo...investors.

MATT

It's funny you said making the truth clear, in a business that relies almost totally on trust.

PATRICK

Yes, and that's one of the problems of the financial services world, and to varying degrees we aren't always earning the trust people put in us. And true honesty about what we can and can't do (clears throat) unfortunately gets in the way of how much money we make. So the more honest you are as an advisor, the less you might be making in fees. That's the unfortunate reality.

MATT

Let's turn that a little bit right now. Is that what's happening to money managers? Explain how money managers make their money.

PATRICK

Money managers make their money from fees on the assets people have placed with them. And the big problem is that most money managers are trying to, what's called, beat the market, and the problem is, the people trying to beat the market charge a lot of money. Fees that run up to 1 ½% a year, that you never see, it just disappears from your account, and the problem is, most of the time, they're not beating the market, they're actually behind.

MATT

On average, can you say that most money managers do not beat the market?

PATRICK

Yes, absolutely, as an industry, money management...active money management does not succeed in beating the market, and that's very, very well documented in academic research.

MATT

Try that answer again, nothing wrong with it, I just want you to re-say it. Can you tell me, and maybe paraphrase my question in your answer, can, do most of the money managers out there do not beat the market?

PATRICK

Most of the money managers fail to beat the market.

MATT

So it's a gamble (laughs)

PATRICK

Yeah, and it's a gamble stacked against you. There's some gambling where the odds are really bad and some where it's better, and that's the whole point of something like indexing, is that the odds are much much better in your favor.

MATT

You brought up indexing, let's talk about it then. Uhh, what is indexing?

PATRICK

Indexing is a way of investing where, at it's simplest form, you buy the entire stock market. All the stocks, and you roll it up into one simple investment that is not trying to outperform the market, it is the market.

MATT

And money managers make their money by saying, I can beat the market which is basically the index?

PATRICK

Correct!

MATT

And why can't they beat an index?

PATRICK

Because...

MATT

I stepped on the beginning of your answer, let me start again. Why can't they beat the index?

PATRICK

Because they're actually also smart, they're really really good at their jobs, and they can't find value that other people can't find, and they cost too much. It's not that they're not smart people, they're really, really good at their jobs, they're just way way too expensive. So they can't beat the market because they're like running a race, carrying an extra backpack of heavy fees.

MATT

Can I as an avg investor, be better than someone who's really smart, like you just talked about, that knows, who wants to beat the market? In the bigger picture, am I gonna have more bang for my buck if I don't give these fees to money managers?

PATRICK

Yes, and that's the counterintuitive part of this, how to invest, is the really simple approach of indexing, is superior, most of the time.

MATT

Let's talk about ... how do the super wealthy invest? You were part of that network, explain what you were doing, how were you a part of the super wealthy?

PATRICK

Well most of our clients are high net worth, multiple millions of dollars, tens, even hundreds of millions, very well off. And there are a lot of financial advisors serving the very wealthy, and there's a myth out there, that we add (hits mic on shirt) some amazing value that ...

MATT

(Asks question again) Explain this myth that the avg investor can't get access...

PATRICK

There's a myth that the really wealthy ppl can go buy very very good advice and b/c of the size of their portfolios, they're gonna get excellent advice, the problem is, there's a lot of good advice for the wealthy, there's a lot of bad advice. In a lot of the financial services world, the wealth advisors that are serving the very very wealthy are actually giving them very expensive, poor advice, and they're not better off. But there's this assumption that just because you're paying lots of money for advice, you're better off than what a lot of other investors can do.

MATT

... Gonna say it again. The myth that the common person would have watching this show, who thinks, I'm just a slob investor, I can't afford to get into a hedge fund, I can't afford to get these guys, I don't even have a million dollars to get these guys. And then they take their exorbitant

fees out. Is it a myth that even the common investor cannot get into these vehicles? The so called super wealthy?

PATRICK

No, it's accurate that you can't get into those vehicles, it's a myth that you're gonna do a lot worse because you can't. And one of the, some of the evidence to that is, some of the big institutional investors, like the really big pension funds, they do a lot of indexing. They take this very simple approach and they have billions of dollars and can hire the best money managers and they don't. They do the simple, low cost approach called indexing.

MATT

Explain to me how, I'm gonna have you give me the insider look at how a wealthy person approaches the money, someone like you, someone who runs a fund, how the fee structure works, how they get paid. I come to you and I have a million dollars to invest and I'm not gonna do it on my own, I'm gonna give it to you and just trust you. How do those super wealthy invest with these guys? Is there a simple way to explain to the layman how it works?

PATRICK

Most of the super wealthy are hiring what's called a wealth manager that does the overall picture of the pieces of the portfolio and then they hire individual, what are called money managers. And the important thing about the fees is to understand you're paying both the wealth manager and the money manager. You're paying the wealth manager who's doing the overall picture, and all the pieces, like US stocks foreign stocks, you're paying that managers that deliver all of those pieces. The trick is you gotta look at the total cost, the entire portfolio, what are your entire fees.

MATT

And someone who pays a wealth manager and several money managers, how much does that cost?

PATRICK

Typically, the avg wealth manager is charging 1% down to about 1/2% a yr, they're also paying 1 and 10% to the money managers so the total fee cost tends to run 2-2 1/2% and that takes a huge bite of your total profits and that can really affect your total wealth at the end of the day.

MATT

Would these super wealthy be better off to invest like the avg guy? The Schwab guy I'll put it?

PATRICK

They'd be better off paying a lot more attention to fees than they do. It's oversimplifying to say they shouldn't do anything fancy, but the wealthy aren't necessarily any better consumers, smarter consumers than the avg investor.

MATT

Don't the wealthy, because of all the money they can pay fees, have access to better managers? I mean you have better trusting managers rather than buying an index fund. An index is boring, we'll get to that in a second, just by nature of someone who has a lot of money to spend and therefore a lot of money to lose can afford to give these guys a shot to beat the index?

PATRICK

They can afford to take that shot, but the odds are still heavily stacked against them. Just b/c they have a lot of money to pay the fees, doesn't mean they're getting good value for their money. And that's where the institutional investors, like the big pension plans, they have lots and lots of money to spend on fees, and they decide not to. They decide to go with the simpler approach of indexing, so wealthy investors can afford to pay really high fees, but they don't necessarily earn any higher returns and the odds are stacked against them just the way they are for the rest of us.

MATT

Why is index boring?

PATRICK

Because you're not beating what sounds like avg. You know Americans are great competitive ppl, we like sports, we like scoring things, and if you go tell someone, "I'm an avg player," that just sounds disappointing. You're not gonna be at a party somewhere, bragging about indexing. How'd you do last yr? I did what the stock market did. Well how'd you do 5 yrs ago? I did how the stock market did. It's not an interesting story. It's a very smart way to invest, but it's not sexy, it doesn't have the zippy story element of finding a manager who picks stocks that do better than the market.

MATT

So why if over the long haul, indexing is your best bet, why are billions and billions put into hedge funds, why does it keep on going?

PATRICK

Because our brains are hard wired to think we can do better by trying harder. And indexing vs this active approach, you don't on avg do better, you actually do worse. It's so counterintuitive to think you're settling for avg, when in fact, you're settling for what's usually the top cortile. Why is that? B/c indexing is really cheap. It doesn't cost as much. So the active management is a bad idea b/c it's so expensive.

MATT

As a money manager, ... you dont want to push for boring cuz you dont make enough...

PATRICK

Exactly, the money managers have a very strong incentive to maintain the illusion that they can add value all the time. And the investing public kinda buys into that mythology, and its a combination delusion in an industry that's very happy to keep ppl in the dark about that.

MATT

Who's better off? The person who pays a lot of fees or someone who has to spend some time doing their own homework and does it for low fees but does their own research?

PATRICK

Neither, the person who doesn't do any research, takes the incredibly simple answer of index funds, on avg they are gonna be much better off. You can either pay someone to do that research for you, or you can do it yourself, or you can skip all the research and just index, and it's a very small investment of time. That's one of the mythologies, it's I need to spend hours and hours every week and really stay on top of the market. Complete mythology, you can look at the market once a yr, once every 2 yrs and you're just fine.

MATT

So I just heard you say that advice on TV, I'm now gonna go to my computer, and google "index funds" oh my gosh, look at all these index funds. He just said indexing, I thought there was just, I know I can buy the whole market, but what about these other indexes, what? And even at that point what do I buy?

PATRICK

The first step you need to do is get the total what we call asset allocation down that fits your timeline. How long are you investing for, how much can you tolerate the ups and downs? Once you've done that piece, and that actually takes some work delivering say the stock market is actually very easy. Just pick the index funds that represent the biggest market piece as possible. So for example, the total US stock market is covered by a lot of different index funds, offered by a lot of companies. Then you've got one fund and you've got the entire US market. You can do one other fund, and do the entire foreign market. So do very big chunks at a time, basically when you buy one US fund and one foreign, you own capitalism. You own, in effect, every company you've ever heard of, you own a little piece of it. And that's a very smart, albeit simple way of investing.

MATT

Then in your expertise, can you say here, that over the long run if I buy the foreign market the US market, I will be better off than the ... without me, if you can paraphrase that go ahead and do that.

PATRICK

You will be better off, on avg, by buying the entire US market, the entire foreign market and saving all that money on all those extra expenses for active management. The research is really really solid, coming out of the academic finance ppl of universities. It's very well established, this is not some crackpot theory. Very well respected, and broad, across a lot of research, indexing on avg works better.

MATT

That's just not a sexy answer.

PATRICK

It's a dull, boring, and that's one of the problems of trying to explain to ppl not to get caught in the hype of all that fund stuff in active management. The dull answer is actually the best for your retirement, but it's gonna be a lot less fun. You'll have more fun in retirement, but you'll have a lot less fun along the way because when ppl ask you for your stories, you have to give them the same answer. It's a terrible way to make money if you're an investment advisor b/c it's too boring, it's even a problem in how the financial press covers investing b/c indexings a really really dull story. Makes bad copy.

MATT

You know, these are words to put money managers out of business.

PATRICK

Uhh, money managers should be making a lot less money than they do. And that would be a very good thing for investors. One of the great lines I heard about active money managers is, they're only three kinds of ppl in the world who don't believe in capitalism: the North Koreans, the Cubans, and active money managers.

MATT

(BG laughs) Gonna all have red flags on their cars. Just about 2 more questions. In your experience do the wealthy investors know what they're involved in?

PATRICK

Not really, I don't think wealthy investors really understand what services they're buying. And in that sense they're not really different from the rest of us. And that's the biggest challenge to being a smart consumer: know what you want from a money manger, a wealth manager, and understand the fees. Understand what you're buying and what you're paying for then.

MATT

I mean you kinda categorized that the fees, let's talk about hedge fund fees here. That's not just 2% of whatever it is. You always hear about wealthy investing and hedge funds. How is the typical fee schedule of hedge funds? How do they make their money?

PATRICK

A hedge funds make their money 2 different ways, they make a standard fee on assets, plus 20% of usually some kind of excess return. So a hedge fund, when you hear it described as they charge 2 and 20 that means 2% of the assets 20% of the excess profits.

MATT

And hedge funds are basically unregulated funds?

PATRICK

Correct.

MATT

And explain why that is such a sexy investment for the wealthy...

PATRICK

Hedge funds are sexy b/c they're really exclusive, and if I can get into a hedge fund that you can't get into, that means, I'm a bigger player in the world and you should admire my inside connections. So there's a lot of conscious consumption, just like if you see me driving a really flashy car, I'm showing off to the world how wealthy I am, that's how a lot of the hedge fund space works, ppl are showing off their connections and the cache associated with that.

MATT

Overall then, we were talking about money managers and wealth managers, hedge funds and these ppl who are spending even more to be involved in a sexy investment, are they better off than someone who is just buying the market?

PATRICK

My suspicion is they're not. The data is unclear, since they're unregulated they don't have as clear info on them. One thing that's very clear though is in 2008, there were a lot of wealthy investors really disappointed b/c they thought their hedge funds were going to protect them against big downturns and they didn't. And there was a big shock, and there's kind of a backlash going on now, in 2009 about how the cache in hedge funds and the very wealthy. How they all need to be there, there's a bit of a pullback from that.

MATT

Summarize ... give an opportunity to hone in on one thing you want to talk about, I'll go back to the myth: that super wealthy have better info than I can get as a guy who sits down at his computer and Fidelity fund, Schwab whatever you want to call it. Let's talk about the myth. Is it a myth that the super wealthy have better access to info than I as the avg joe consumer?

PATRICK

It's a myth that when the very wealthy are paying for financial advice they do better than you or I would paying much less, more of a retail level. So the really wealthy do have access to a wider range of investment vehicles. And there are a lot of really good advisors out there, for the really wealthy, but just because you're very wealthy doesn't mean you have a better chance of getting good advice than a retail investor who is facing the same advice. A lot of the advice is wrapped around what helps the industry, not what helps the consumer.

MATT

I'm just thinking of a quick parallel here of another industry that's very advice driven: doctor. You can go in for a consultation, I can go into a clinic, which won't cost me anything, or I can go into a specialist. Is that an unfair, I mean money managers position themselves as I am a specialist, and you go to Schwab, you're going to get pedestrian advice.

PATRICK

Yep, and in the medical world, where I would hold that perception and as far as I know is valid, b/c there are no proven data that the very high end doctors on avg aren't any better than the ones that are low cost clinics. Unlike the investment world where there is overwhelming evidence that the expensive managers, on avg, are not adding much value. And that's what makes it so different from the medical profession, is we've got documented proof that they're not really adding that value.

MATT

I want you to try that answer again w/o comparing the medical, you said there's overwhelming proof that high end, I'm trying to do the same answer w/o the medical, can you try that again?

PATRICK

There's no documented proof that the very wealthy are getting better advice for the dollars they're paying than for retail investors. The myth is that, oh the wealthy can afford really good advice and by definition they get really good advice for investing, and they don't do any better than the retail. Some advice is good for the wealthy, there's a lot of really bad advice out there, targeted at the very wealthy. One thing is that the wealthy, say they started a company and are selling it, and they're really really good at what they do, they wouldn't have gotten \$100 million if they weren't good at it. I was really good in a transportation company, a software company. They go over to an investment world and think, I'm gonna be a genius over there too. The problem is, in their original business, maybe in tech or transportation, they may have had very little competition, there was something they could do that was really unique. Take them over to the investment world and they've got millions and millions of really highly paid ppl competing with them, all trying to do this same thing which is beat the market. And they bring this supposition of I did it once in one industry and I can do it in another, and the rules are completely different.

MATT

Final anything that pops into your head, what we've been talking about?

PATRICK

Focusing again on indexing being boring, fees are really boring and can be complicating and is the most important thing that every investor needs to know is you have to focus on the fees. If you don't know what you're paying for investment advice, you're a patsy, you're at risk of getting taken. And I cannot emphasize enough how ppl need to wake up and be smart consumers by paying attention to the fees they pay investment managers.