Dimensional

PERSPECTIVES

Trust the Financial Advisor Who Trusts the Market

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With over 200,000 financial advisors in the United States, how do you pick one?

First, eliminate the stock pickers. Those are the people making predictions about which stocks are going to be winners and losers. Cross off the market timers, too. They're the ones who get into and out of the market, trying to buy the dip and sell at the peak. The problem with these strategies is that it's unlikely any individual will be able to pick the right stock and the right time—especially more than once.[1] Over 50 years of research confirms that people can neither pick stocks nor time markets consistently year after year. The smartest person on the planet isn't as smart as the market. Markets are smarter than advisors and smarter than I am.

Why is that so? Markets do a sensible job for sensible reasons. Buyers and sellers have to come together to make a trade. Prices have to be low enough to attract new investors and high enough to entice someone to sell. Both sides have to feel good, or they don't make the trade.

That's why you should trust the financial advisor who trusts the market.

These are people who help investors try to capture the returns of the market rather than attempting to outsmart it. Decades of research supports this strategy. So does the explosive growth of index funds.[2] Our company is based on additional research that has provided insights into how to pursue higher expected returns than index funds offer. But all these strategies are based on the commonsense idea that markets do a good job of incorporating information into prices. We see that every time a big piece of financial news sends stocks up or down.

Think of the market as a giant information processing machine. Prices change as millions of buyers and sellers react to new information coming into the market. Prices settle at "fair" values that seems reasonable to both the buyer and the seller. This should be reassuring to people and give them the confidence to trust the market rather than to fight it.

Historically stocks have returned about 10% per year.[3] That's about 7% above inflation and 6% above what people think of as riskless assets like money market funds. Naturally there are variations, and there is no guarantee, but I think these are generally reasonable returns to buyers of shares in a company. Markets seem to operate the way people hope, which gives us a fair chance of winning.

What's the catch in all this? It's daunting to figure out what exactly to do, how to develop an investment plan. But you can't avoid it. Few things are more important than developing a well-thought-out plan when investing your life savings.

In my experience, it's easy to agree with these principles, but it's hard to stick with them when times get tough. You need to be a long-term investor.

If you accept these fundamental principles of markets and how they work, you owe it to yourself to find an advisor who does too. So trust the advisor who trusts the market.

1. Eugene F. Fama and Kenneth R. French, "Luck versus Skill in the Cross-Section of Mutual Fund Returns," Journal of Finance 65, no. 5 (2010): 1915–1947.

2. Index investing has grown considerably in recent decades, with US equity index funds representing 52% of the US equity fund market at the end of 2021. Data sourced from Morningstar; funds of funds are excluded.

3. In US dollars. S&P 500 Index annual returns 1926–2021. S&P data © 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

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