The Best Sales Tactic in Finance

I had a great conversation on Friday afternoon with Jeremy Schwartz on his Sirius XM show, Behind the Markets. Nir Kaissar was also on the show so we had a nice back and forth on institutional asset management.

Jeremy asked me why the institutional investment industry tends to lean towards complexity when building portfolios or offering advice to the various funds in this space.

In my latest book I gave four reasons for this:

1. It's Interesting. *What sounds more stimulating as an allocator of capital? Traveling to New York, Silicon Valley and London for due diligence trips to meet with hedge fund, private equity and venture capital managers; getting wined and dined with free food and booze while getting to hear about complicated strategies, alpha, new technologies and 'what sets us apart' in an effort to beat the market and your peers. Or choosing a sensible asset allocation, keeping costs low, staying operationally efficient, avoiding crippling mistakes, setting reasonable goals and doing nothing most the of time. It's obvious why the majority of large investors choose option a, but that doesn't mean these funds will be better off financially from this decision.*

2. They Think It's Their Job to Outperform. *Most institutional investors assume their job is to outperform the markets and their benchmarks to earn their keep (and most likely a performance bonus). Most board members are also very successful in business, ultra-competitive and want nothing more than to beat the performance numbers from endowments like Harvard and Yale. But it's not enough to beat their peers. Many also have to somehow prove their intellectual superiority by making their portfolios and strategies so opaque that most people within the organization have no idea how the money is actually being managed. It's an ego contest. Everyone wants to beat everyone else even with different goals and somehow complexity becomes the norm.*

3. They Assume Complex Must be Better. *The investors that run complex portfolios are highly educated individuals who are very intelligent. It can be hard for them to admit that a simpler solution makes the most sense. There is a false sense of security in doing what everyone else is doing. The assumption is that complex financial markets require complex solutions, but new and exciting is not the same thing as useful.*

4. Social Validation. *Psychologist Robert Cialdini has shown that one of the main filters we use to make decisions is by looking at the decisions of others. Social proof is the idea that it feels more comfortable to go along with the crowd when making tough decisions because we look at what others are doing in times of uncertainty. Investors with lots of money at stake tend to feel that they have to use "sophisticated" investment strategies that cost a lot of money in order to keep up with their peers. I've seen complexity fail over multiple investment cycles in these types of portfolios, but as Keynes told us, "Worldly wisdom teaches that it is better for the reputation to fail* *conventionally than to succeed unconventionally." Simplicity has become the exception, while complexity is now the rule.*

Something I missed here is the fact that complexity sells really well in the institutional world.

Look how great Yale's endowment has performed over time! We can help you do the same!

People confuse simple with easy and complex with sophisticated. It's easier to sell complex strategies and ideas. Complexity leads to a false sense of job security under the guise of expert status, black box strategies or intellectual superiority.

Complexity is a wonderful sales technique because it makes you seem indispensable.

Nassim Taleb covered the idea of complexity versus simplicity in his book, Antifragile*:*

A complex system, contrary to what people believe, does not require complicated systems and regulations and intricate policies. The simpler, the better. Complications lead to multiplicative chains of unanticipated effects. [. . .] Yet simplicity has been difficult to implement in modern life because it is against the spirit of a certain brand of people who seek sophistication so they can justify their profession.

Here are some of the unanticipated effects of defaulting to a complex investment strategy:

- Fewer people understand what they're actually investing in so at the first sign of trouble they panic or have no idea how to react.
- Investors change strategies more often because they never had an overarching philosophy to begin with.
- It becomes easier to get swindled by scams or buy into false claims by professional investors or consultants who are more adept at selling than investing.
- Investors are willing to pay a charisma premium simply because a portfolio manager or firm give off the aura of intellectual superiority.
- People assume that they will be awarded points for degree of difficulty in the markets.

In many ways, a simpler approach to investing is more challenging than a complex approach because simple can be harder to adhere to. Simple doesn't make for a compelling sales pitch. It's not sexy. No one brags about simplifying their investment strategy to their peers. People assume simple means simplistic.

This is not to say a more complicated approach can't be done. It can. But those organizations who can pull it off are few and far between. For everyone else, simpler is likely the better route.

Further reading:

[Advice Doesn't Have to be Complicated to be Good](#)