

Information Technology in Today's Market

"Resilient" would be an apt word to describe the stock market in the first quarter. Consider the daunting list of challenges that faced investors during the past three months:

- Regime change in Tunisia and Egypt, U.S. involvement in an all-out civil war in Libya, and democratic stirrings in many other Middle Eastern countries, including Yemen, Bahrain, Syria, and even Saudi Arabia.
- Oil prices increasing from \$91 at the beginning of the year to over \$106 today.
- A cataclysmic earthquake and tsunami in Japan, leading to a partial meltdown at a Japanese nuclear power plant—the ultimate effects of which are still unknown.
- Ongoing—perhaps worsening—fiscal difficulties on the periphery of Europe.
- A possible federal government shutdown as Republicans and Democrats square off on spending cuts and the unpalatable, yet necessary, increase in the federal debt ceiling.
- The approaching end of the Federal Reserve's current round of quantitative easing in June—what will happen when the Fed stops supporting the U.S. Treasury Bond market?
- Further declines in housing prices in 19 out of 20 major markets.

If given a crystal ball which foretold these events, any logical person would probably have sold his or her stocks and run for the hills. How could stocks possibly rise given these multiple blows to investor confidence? Yet all major equity classes rose significantly during the first quarter. Some market watchers attributed the increase to a major asset allocation shift from bonds to stocks, while others cited the fundamental strength of corporate balance sheets. For us, the seemingly paradoxical first quarter is a perfect illustration of why it is nearly impossible to time the stock market.

Index	Asset Class	First Quarter 2011
Short/Intermediate-Term Bonds	Fixed Income	0.3%
S&P 500	Large U.S. Stock	5.9%
Russell 2000	Small U.S. Stock	7.9%
MSCI EAFE	Foreign Stock	3.4%
Dow Jones REIT	Real Estate Securities	6.7%

OUR PROFESSIONAL ADVISERS

Mark Dowling, CFA, CFP®

MARK.DOWLING@DYWEALTH.COM

Dale Yahnke, CFA, CFP®

DALE.YAHNKE@DYWEALTH.COM

Paul Temby, CFA, CFP®

PAUL.TEMBY@DYWEALTH.COM

Will Beamer, CFA, CFP®

WILL.BEAMER@DYWEALTH.COM

Alana Asmussen, CFA, CFP®

ALANA.ASMUSSEN@DYWEALTH.COM

Jacqueline Bell, CFA, CFP®

JACQUELINE.BELL@DYWEALTH.COM

Questions?

Please e-mail or call us at (858) 509-9500.



Adviser Corner



Paul R. Temby, CFA, CFP®

PARTNER

Paul joined Dowling & Yahnke in 1998 and became a Partner in the firm in 2005. He holds the designations Chartered Financial Analyst (CFA), CERTIFIED FINANCIAL PLANNER™ (CFP®), Certified Divorce Financial Analyst™ (CDFA™), and has a Master of Business Administration (MBA) degree with an emphasis in Finance from the Wharton School, University of Pennsylvania. In addition, Paul holds a Graduate Diploma in International Business

Administration from the Université Catholique de Louvain, Belgium and a Bachelor's Degree in Mechanical Engineering (Magna Cum Laude & Phi Beta Kappa) from the University of California, San Diego.

Paul is a California native, but has enjoyed living in many parts of Europe. He is married and has two children.

In our last letter, we reflected on some of the changes that have taken place in the investment advisory business in the twenty years since we opened our doors in 1991. In particular, we discussed the rise of the independent registered investment adviser (RIA). In this installment, we turn our attention to another major shift: the rise of information technology and the impact it has had on our business and investors at large.

Consider the following: twenty years ago, much of our work was done in the office using landline phones and fax machines. Most trade orders were placed by telephone, at commission rates several times what they are today. There was very little ability to perform “work,” as we know it today, from home or outside of the office. We garnered information on investments primarily from print subscription sources. Client information was kept in paper files, in bulky file cabinets.

At Dowling & Yahnke, we have a strategic, ongoing effort to invest in best-of-breed technology. With a constant focus on data security, we utilize technology to allow us to serve our clients more accurately and efficiently. For example, today incoming faxes are immediately converted to digital files, which are quickly and securely routed to our computers. For rapid communication, we spend much of our day reading and composing e-mail, which did not exist twenty years ago. Leveraging technology, we can be highly mobile and highly productive, working from home or on the road, using secure mobile devices. In addition, the Firm continues to strive to become “paperless” by leveraging digital information sources and transforming traditional paper files into highly secure, electronic files. We continually evaluate new technologies in an effort to serve our clients better.

The positive impact of information technology on business productivity is indisputable. A separate question is whether easy access to an enormous amount of information in real-time has made the general public better investors. Without doubt, investors today have access to vast amounts of data at very low cost. Hundreds of cable channels (some devoted solely to business and investing), websites and blogs, Facebook and Twitter, as well as more traditional sources like broadcast TV, newspapers, and magazines, all compete for our attention every day with “must-read” articles, Top 10 lists, news alerts, and friend requests. The evidence suggests, however, that most investors are no better off today than they were twenty years ago.

Approximately two-thirds of active stock mutual fund managers still underperform their benchmarks. The figure is even worse for bond fund managers. Mutual fund flows demonstrate that the average investor still buys high, piling into mutual funds with strong recent performance, and sells low following the fund's performance decline.

Why hasn't improved access to information led to better investing? We believe there are two major reasons. Access to data alone does not necessarily lead to wise investment decisions. What investors need more than ever are intermediaries that can filter the data, separate the wheat from the chaff, and extract the pieces that are relevant to the question at hand. Intermediaries come in many forms: intelligent human analysts and portfolio managers, software tools and models, consulting firms, etc. A quick example: merely listening to a CEO interview on CNBC is unlikely to provide the viewer with valuable, actionable investment information, but an astute analyst who closely follows the CEO's company may be able to "read between the lines" of the interview, incorporate other contextual information regarding the company's competitive environment and the economic backdrop, and develop a much more vivid and persuasive outlook on the company's future. Tools for accessing information have grown much faster than the number of smart intermediaries that filter and make sense of it. Those filtering tools that deliver a real information advantage to their users are, not surprisingly, often priced at a premium.

"Access to data alone does not necessarily lead to wise investment decisions."

The second obstacle for investors in the Information Age relates to human nature. All of us have internal biases that cause us to assimilate new information in certain ways. We tend to readily accept new information which reaffirms our prior held beliefs, while we discount or flat-out reject information that contradicts our previous thinking. In other words, most of us are not very open to major changes in our worldview. Moreover, human beings are social creatures who want to be part of the crowd. Making contrary investment decisions, such as buying securities as their prices are falling or reducing positions as prices are rising, is very difficult for most people, because standing apart from the crowd is, by definition, a lonely and isolating endeavor. Increased access to information has done nothing to change the laws of human nature, and we see little reason to believe that human behavioral tendencies will change significantly anytime soon.

As advisers, we strive to be intelligent intermediaries for our clients, distinguishing what is truly important from all of the background noise. We also help our clients counter the sometimes detrimental effects of their behavioral tendencies. Rebalancing portfolios is one very simple example: by selling asset classes that have performed well recently, and buying those that have performed relatively poorly, we are helping our clients behave in a way that is contrary to the herd mentality.

