How to Rebuild Investors' Trust With Communications that "Walk the Walk"

The investment industry is in the process of turning a long corner, with limited visibility as to what lies around the bend.

In 2008, financial markets produced their worst annual performance and most unsettling environment since the 1930s. Many retail investors experienced sharp declines in the bedrock assets of their net worth, home equity and stocks. Many institutional asset managers, especially hedge funds, experienced record redemptions. The global financial system wobbled and its key structural components required emergency government repairs, which further damaged the confidence of retail and institutional investors alike.

For decades before turning this corner, the investment industry had achieved spectacular marketing success, attracting trillions of dollars into stocks, mutual funds, exchange-traded funds, derivatives, hedge funds, and assorted financial exotica. Although the industry's message had many nuances, at its core was a constant mantra:

"Trust the economy and markets. Trust us to guide you through it."

Around the corner, investors' acceptance of this message – and the messengers who delivered it – will be shaken, for clear reasons:

1. Many financial forecasters and analysts failed to predict the downturn and then dismissed its severity even as storm clouds gathered. Their credibility has suffered, along with that of the firms that employed them.

2. The government intervention required to bail out failed financial institutions will serve as a reminder of the price everyone must pay for financial excess. As taxpayers comprehend the vast costs that they and their descendants must bear, resentment against financial companies could grow.

3. The Federal Reserve has expanded and diluted its balance sheet more in one year than previously and cumulatively in its 95-year history. The Fed's balance sheet stands behind the promise to repay its debts – namely, U.S. dollars. Thus, it has become more difficult for investors all over the world to value the dollar and dollar-denominated assets.

4. Financial regulators and major ratings agencies let their guards down, leaving retail and institutional investors vulnerable to a lack of information about how risky exotic financial instruments were. Now, financial companies will face a harsher regulatory climate as regulators address their deficiencies with action (and perhaps over-reaction).

A short while ago, U.S. investment firms and their inventions inspired awe all over the world. Now, they face an era of retrenchment, regulation and potential resentment. Investment relationships require a sense of trust, and firms can no longer assume that their traditions, size or expertise will inspire it. Therefore, they must work harder and smarter to earn it.

We believe forward-thinking investment firms can change the tone and substance of their marketing communications to rebuild investors' trust over time, starting now. Rather than talking about why investors should trust them, they will describe in clear terms the actions they will take and the deeds they will perform to earn trust, step by step. In short, they will stop "talking the talk" and start "walking the walk" – saying what they mean and then doing everything they say to help retail and institutional investors pursue specific goals.

Observations on Investment Communications

Ulicny believes a fundamentally different environment lies around the corner for investment communications. The messages and imagery that have served the industry in the past will not work as well – and may even become a negative – in the future. However, we also believe that forward-thinking companies will adapt to the new era by communicating a different set of values in a more-humble yet still-confident voice. In this report we articulate:

1. The fundamental changes we see taking place as investors turn the corner, such as "straight talk" about risks and how they can be monitored and managed to help investors preserve assets through turbulent markets.

2. Why it is important for investment firms to examine their current communications and core messages – with sensitivity for how they will be perceived by investors going forward in a changed environment.

3. Our thinking on what types of messages will work best "around the corner."

We wish to emphasize that we are not forecasters, and we are not offering a view on where the economy or financial markets may be heading. Our business is helping investment firms define and differentiate themselves for target audiences and then develop effective core messages and communications media. Sticking to what we know, we offer two basic observations that may help companies turn the corner.

Observation #1: Before 2008, the investment industry had successfully built trust with its investors across diverse client segments, products and services. That trust rested, in part, on a series of values and messages that were constantly repeated and reinforced, until they collectively became a kind of mantra.

Now, some firms recognize that investor's trust has been shaken, but they still believe a "return to normal" will restore it. They can't let go of the old mantra.
Observation #2: It is hard for investment firms to let go of old messaging until they have evaluated and accepted alternatives. We think an alternative is to emphasize straight talk – what we call "walking the walk." This type of messaging will explain risk factors in unvarnished terms and then persuade investors that risks are worth taking based on clear, detailed descriptions of risk-management processes and asset preservation strategies. It won't require trust in a growing economy or a rewarding market environment to deliver value.

How to Avoid the Same Pitfalls

The stressful environment of 2008-09 has reawakened in investors all over the world a fundamental truth about why they buy investments, regardless of their wealth, sophistication or portfolio size. They are choosing to convert their basic cash or savings into more complex financial instruments that offer opportunities to achieve specific objectives over time such as capital growth, current income or inflation protection.

In making this choice, investors rely on many intermediaries who help them evaluate complexities and risks – including advisers, asset managers, analysts, consultants and product suppliers. In the past, investors have been inclined to believe that most intermediaries were informed, competent and honest. They tended to accept intermediaries' words at face value.

In many cases, however, the words used by intermediaries did not clearly and accurately describe complexities and risks in terms investors could understand. Rather, they focused on repeating familiar ideas, images, slogans and statistics that had tended to work and inspire trust, even after they had become outdated, debatable or dubious. In some extreme cases, investor trust was built on quicksand rather than a solid foundation of real investment consequences or intermediary performance.

This extreme was demonstrated recently when the Bernard Madoff scandal broke across front pages. The story behind the headlines was the complacency sophisticated investors, including institutions, had shown in entrusting their savings based on blind faith, instead of a clear understanding of how their money was being invested. Their losses in this stunning lapse effectively became all investors' wake-up call.

Going forward, we believe that investors will trust their painful and real experiences more than clever imagery or familiar mantras. In many cases, they will choose investment intermediaries tentatively, based on a "contract" that describes in clear steps what the firm will do to help them manage risks, preserve capital and meet specific goals. Real trust and solid long-term relationships will then be built as investment firms "walk the walk" of the steps they have communicated, performing each reliably, in real time, and with full transparency.

Do Your Communications "Talk the Talk" or "Walk the Walk"?

Are your communications ready to motivate new investor relationships and retain existing clients in the new environment? You can begin to answer this question by auditing your communications against our checklist of outdated ideas (and suggested alternatives) below.

Inertia is good – One consistent theme of the old mantra has been that investors can participate in a strong economy and market growth by following inertia-driven processes such as systematic investing, buy-and-hold asset allocation, or pre-programmed target-date portfolios and index investing. The mantra holds that investors should stick to these "disciplines" through thick-and-thin because the opposite approach, market timing, doesn't work.

But there is another viable way for investment firms to dampen the impact of losing strategies in volatile environments – by implementing timely risk management processes designed to preserve capital. Around the corner, more investors will question whether inertia-driven investing works to their benefit, and they will demand more attention to monitoring risks and mitigating losses in difficult times.

Detached risk tolerance – Risk tolerance is an intrinsically positive concept for changing times. However, due to suitability rules and industry practices, it has become etched in the minds of many investors as a mechanical one-time process – a questionnaire completed or asset allocation model chosen. In the real world, risk tolerance is dynamic concept that keeps changing with current conditions. Whether the investor is a "Mom and Pop" account or a large institution, risk tolerance can change based on the investors' circumstances, portfolio results, and economic realities. For example, many defined benefit pension funds experienced two events (at about the same time) that increased their future liabilities – passage of the Pension Protection Act of 2006 and plummeting U.S. Treasury interest rates, based on Fed policies. Investment guidance offered to investors should communicate how firms intend to monitor and adjust risk exposures when such unusual impacts occur.

Selective objectivity – Some investment providers have touted their “objectivity” in helping clients evaluate choices, even when it is clear that they have biases in favor of specific asset classes or strategies. For example, one axiom of the trust-based mantra holds that investors should not try to time the stock market, because missing even a few of the best-performing market days would have dramatically reduced long-term returns. However, an objective comparison would show the results of missing both the best-performing and worst-performing market days – and such balance is not always offered.

Little-picture thinking – In 2008, some fund managers and analysts missed changes in the “big picture” because they were too focused on evaluating investment markets through narrow portholes of specialization. For example, some “bottom-up” managers insisted that sectors of the stock market were undervalued based on their evaluation of quarterly income statements and P/E ratios. Meanwhile, they missed the macro-trends of de-leveraging, deteriorating fundamentals, balance sheet write-downs, and global earnings declines. Investors will demand more macro-economic overview in the future, along with the flexibility to respond to changing data and emerging events on a timely basis.

Soon-forgotten planning – Some retail investment firms have touted their holistic planning processes at the start of client relationships – yet failed to protect clients by keeping planning current. For example, a basic planning rule holds that retail investors should keep 3-6 months of living expenses in liquid assets, just in case. When times turned stressful in 2008, many investors felt vulnerable because their liquidity levels had not been monitored and maintained over time. Planning should be a serious promise to investors with structured steps to follow – not a marketing slogan.

Mumbo-jumbo opacity – Institutional performance reports often have “talked the talk” using complex terms (“stress tests, VaR”) and opaque formats. What investors really wanted to know, but often couldn’t learn, was how institutional fund managers would respond or perform in an unusual, difficult market environment. Unfortunately, many of them finally found out the hard way.

One way to “walk the walk” is to give investors the transparency of periodic performance updates that clearly disclose returns, the level of risk and specific actions taken by the portfolio managers to enhance returns or mitigate risks. Easy-to-read reports help investors obtain this information quickly and build their trust.

Diversification that doesn't work – Some firms have promoted efforts to diversify risks while also communicating other messages that work at cross-purposes to concentrate risks. For example, the technique of dollar-cost-averaging works in its purest form when investors commit a set amount of money periodically to an investment with fluctuating prices. But if that investment is not well diversified and monitored, dollar cost averaging can work in a bear market to increase concentration in a declining investment with deteriorating fundamentals.

Similarly, many investors were led to believe style-based asset allocation programs would increase diversification and reduce risks. But they were greatly disappointed by real-world results in 2008, when almost all asset classes fell simultaneously.

What Should "Walking-the-Walk" Marketing Emphasize?

- **Humility and understatement** – Investors will respect and trust firms that don't promise wealth or success but do show genuine respect for market risk. A firm's ability to empathize with its investors' needs, concerns and emotions also will become more valuable. Horn-tooting hyperbole is out. Simple descriptive language is in.

- **Downplaying wealth** – Many formerly wealthy people no longer feel as flush, and they now are more interested in "asset preservation" than "wealth management." In a more difficult economic era, they may not want to flaunt their wealth or be reminded that they are special or privileged. Elegant high-styled prose aimed at elite clients is out. Egalitarian marketing is in.

- **Meaning what you say** – When an investment firm touts its "rigorous risk management process," investors expect the statement to mean: "You will do whatever you can to limit my losses." But unless a firm can explain in detail how it plans to limit losses when a strategy goes awry, such claims should be avoided or toned down.

- **Plainer imagery** – Investment firms have used glossy "lifestyle marketing" to instill trust in their results. However, the color photos of retirees teeing off into lush fairways and glowing sunsets won't have the same impact in a more skeptical, down-to-earth environment. It will work better to describe what a firm offers and does clearly, accompanied by imagery that doesn't raise the bar of expectations so high.

- **Explaining value –** For a time, trust-based financial marketing was so successful that many clients didn't care what investment services cost. Now, investors will be more diligent in comparing costs vs. value. Many analysts believe that the recent financial crisis and bailouts will soon lead to higher income taxes on the affluent. Therefore, messaging also should address the tax cost of investment strategies and describe tax efficiencies clearly.

- **Recognizing basic needs and emotions** – If trust in stock market growth is no longer as powerful or persuasive, then personally connecting with basic human needs and emotions may become more necessary and compelling. Messaging should acknowledge such universal needs as security and stability, especially in times of stress. Creative investment firms will explain how their services can help clients reduce exposure to volatile economic or market cycles.

- **Empowering investors –** The opposite of having blind faith in investment markets is encouraging investors to take charge of their own futures. Messages should emphasize how investors (and their intermediaries) can use flexibility features of financial products to make adjustments or manage risks.

- **Addressing regulations** – In the past, regulations have been treated as "background noise" in many investment communications. In the future, successful firms will acknowledge their regulatory obligations in clear terms and then show how they are going beyond the letter of regulations to provide protection and benefits.

- **Detaching from the market** – Investors who want to ride along with stock market (or segments of it) will continue to discover cost-effective and convenient ways to acquire Beta. Therefore, successful investment firms will emphasize how they add value vs. the market – e.g., adding Alpha, combining low-correlating assets, managing volatility, or making strategic risk adjustments.

Putting Ideas into Action

We believe that **time is of the essence** in pursuing a methodical process to change investment communications for a new era. In the past, investment firms with mediocre marketing could ride the coattails of strong market performance and trusting investors. In a more challenging future, effective marketing could mean the difference between success and failure.

We suggest structuring your firm's process in three phases:

1. **Audit** existing communications to assess whether they will be perceived positively or negatively by your target markets in the future.

2. **Evaluate** alternative approaches for core positioning, values and messaging.

3. **Implement** new communications in planned phases.

In summary, we believe the winds of change in the investment industry are blowing from at least three directions: 1) trends in the economy and markets, which may not follow classic cyclical patterns; 2) changes in how the media, consumers and regulators perceive investment firms and products, which will generally be less favorable in the future; and 3) changes in the risk tolerance of many investors, based on hard lessons learned and real losses suffered.

To communicate effectively and rebuild trust gradually, we urge you to "walk the walk." Don't offer the same old mantras or prescriptions, because they will lack credibility in a changed world. Acknowledge that what investors are experiencing and feeling is real, important and will continue. Then, explain clearly what you will do to help them navigate risks and complexities successfully, step by step.