

DEMYSTIFYING INVESTMENT DECISION- MAKING: HOW BEST TO GUIDE A NEW INVESTMENT CLIENT

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Challenges existed for an investment adviser in guiding a client on how best to proceed with investment decision-making. These challenges were further magnified when the client was a potential new client with minimal background in investing. In this case, the founding principal of a comprehensive, fee-based registered investment adviser firm located in southeastern North Carolina considered how best to proceed. Through educating the new client on investment approaches and providing a means for various analysis, the adviser searched to maintain firm priorities of integrity and trust while aiding his new client on her most sensible portfolio options.

INTRODUCTION

“It’s not whether you’re right or wrong that’s important, but how much money you make when you’re right and how much you lose when you’re wrong,” said George Soros, a famous investor (FINCASH, n.d.). Lincoln Austin, founding principal of United Strategic Advisors (USA), LLC, had seen all too many times how this famous investment quote rang true. Too often investors were more interested in being right or wrong as opposed to understanding investing and knowing when to cut your losses.

It was early in the spring of 2018. Austin had received a referral for a potentially new client, Julie Jackson. After having an initial conversation with Jackson, the two were scheduled to meet to discuss her investment experience and options. The familiar drive from his southeastern North Carolina office over to his satellite office in Pembroke, North Carolina provided Austin with a chance to reflect on prior new client meetings to contemplate his strategy for this meeting.

With over twelve years of experience as a financial advisor, Austin had worked with a variety of individuals on their investment decisions. While similarities existed, each meeting could be vastly different depending on the potential client’s

investment knowledge and background. Obviously, Jackson would have questions. Of course, what questions and how many remained unknown. “How can I guide her into making a sound investment decision?” Austin had wondered.

During the meeting, Jackson explained that she had recently inherited \$10,000 from the passing of her older brother and was considering her options on how best to make her newfound cash flow grow. She knew how hard her older brother had worked over the years at a local manufacturing company. Even during the challenging times, he had managed to save a portion of each paycheck to build a future for he and his family. Now, with his passing, Jackson had an opportunity to continue the legacy of saving and building a future for she and her family. As a result, Jackson was especially nervous about investing. The additional pressure was incredible! She could not imagine risking nor losing the money that her brother had worked so hard to save and grow, as well as entrust with her.

“I am so grateful for this gift and want to ensure that I make the right decision on using it,” Jackson had explained. With very little outstanding debt, she expressed her interest in investments as a potential opportunity. However, Jackson timidly admitted that she had never invested before. Furthermore, she knew very little about where to even begin to make an investment decision. In turn, she had an enormous number of questions. Jackson almost seemed overwhelmed by this decision. Austin could easily see that Jackson was noticeably troubled and anxious on her possible investment choice(s). He was in an all too familiar yet challenging situation of how best to guide a new investment client. However, as stated by Mellody Hobson, an American businesswoman who is the President and co-CEO of Ariel Investments and chairwoman of Starbucks, “The biggest risk of all is not taking one” (Inspiringquotes.us, n.d.). It became increasingly apparent that Austin had to figure out a way to educate Jackson to steer her into making the right investment decision for her. For now, Austin had calmly reassured Jackson by explaining more about his background, company, and work philosophy.

COMPANY BACKGROUND

In 2015, Austin founded USA, which is a comprehensive, fee-based registered investment adviser firm, located in southeastern North Carolina. As the principal founder, Austin’s extensive background as a financial advisor with well-known organizations such as UBS, an investment banking company formerly known as PaineWebber, and Morgan Stanley Wealth Management, formerly known as Smith Barney, had prepared him well for the establishment of USA. Furthermore, Austin’s additional professional background of having founded United Strategic Advisors in New Jersey in 2005 only strengthened his adviser firm operations.

USA provided investors with professional investment advice. The firm promoted itself as a trusted adviser, different from most of the competition; the firm touted its' formation built on two main priorities - integrity and trust. As a fiduciary adviser, Austin placed the client's best interest before his own. He valued educating clients on various aspects of investing to best lead the client into sound investment decision-making. As stated by Benjamin Franklin, "An investment in knowledge pays the best interest" (Ruth, 2020). Therefore, educating clients was paramount to investment decision-making.

DILEMMA

Based on his conversation with Jackson, Austin quickly recognized that he was faced with the delicate professional predicament of how to appropriately guide Jackson. In doing so, several factors must have been taken into consideration.

First, Austin had to decide what educational information was to be provided to Jackson to establish a clear, descriptive explanation of investment theory and analysis. Next, company information should have been provided to enable Jackson to effectively evaluate company performance and market performance. Finally, consistent with his firm priorities, the discussion must have contained a constant theme of integrity and trust. This was imperative in gaining Jackson's business now and retaining her business in the future. Therefore, transparency on the potential influence of different economic conditions must have been disclosed.

Based on Austin's extensive experience, he was quite versed on investment theory. However, he acknowledged that inexperienced investors were generally not familiar with the basics of investing. Austin had hoped to find a balance to ensure appropriate investment concepts were relayed to Jackson without overwhelming her. He took a moment to reflect.

Austin reverted to his firm priorities of integrity and trust. He wanted to support the investment theory with relevant analysis to have served as an illustrative and educational foundation for Jackson.

MOMENTUM ANALYSIS

Austin thought it would have first been helpful to explain the momentum approach to Jackson with a series of momentum stocks that fared well during the 2015 period. Assuming an approach whereby investor stock picks were geared towards stocks that were appreciating in value, he presented the case of Amazon.com Inc., Regeneron Pharmaceuticals Inc., Electronic Arts Inc., and Monster Beverage Corp. These companies had performed well during 2015, and an investor would have been inclined to invest in these firms due to past precedence.

The firms' stock prices were as follows:

Amazon.com Inc.

Beginning of January 2016: \$656.29

Regeneron Pharmaceuticals Inc.

Beginning of Jan 2016: \$516.55

Electronic Arts Inc.

Beginning of January 2016: \$66.01

Monster Beverage Corp.

Beginning of January 2016: \$48.11

Austin wanted Jackson to consider what would have happened if she had used momentum investment strategies and invested in these four companies at the start of January 2016. He wanted her to consider how her portfolio would have fared assuming she held onto the investments until today.

FUNDAMENTAL ANALYSIS

Austin often examined a company's external financial statements through calculation and evaluation of financial ratios in considering the financial health of a company. According to Carlos Slim Helu, Mexican billionaire, "With a good perspective on history, we can have a better understanding of the past and present, and thus a clear vision of the future" (Kaplan, 2021). In turn, ratio results provided indicators of firm stock performance as well as the overall strength of the company. The income statement and balance sheet for fiscal years 2015, 2016, and 2017 were presented for four well-known, established companies. Companies varied across industries and were presented in alphabetical order. (See EXHIBITS 1, 2, 4, and 5 below.) Both the income statement and balance sheet were condensed with amounts presented in millions. Additional company stock information was provided to allow for computations where relevant. Financial statement and stock information amounts were modified. (See EXHIBITS 3 and 6 below.)

EXHIBIT 1

Condensed Income Statement (\$ in millions)

	McDonalds Corp. (MCD)			Target Corp. (TGT)		
	2017	2016	2015	2017	2016	2015
Net Revenue	19,854	21,421	22,109	62,535	60,461	64,193
COGS	9,056	11,048	12,160	44,479	42,756	45,450
Gross Profit	10,797	10,373	9,949	18,056	17,705	18,743
SG&A	1,941	2,075	2,118	12,396	11,620	12,759
Other Operating Expenses	545	1,561	1,615	1,909	1,762	1,713
Operating Income	8,311	6,738	6,217	3,751	4,323	4,272
Other Income/ (Expenses)	(852)	(764)	(513)	(579)	(873)	11
EBIT	7,459	5,973	5,703	3,172	3,450	4,283
Income Tax Expense	2,942	1,896	1,763	625	1,128	1,394
Discontinued Operations Income (Loss)	0	0	0	5	59	37
Net Income (Loss)	4,517	4,077	3,940	2,553	2,381	2,926
Other Comprehensive Income (Loss)	796	(185)	(1,183)	7	(8)	(26)
Comprehensive Income (Loss)	5,313	3,892	2,757	2,560	2,373	2,900
Accumulated Other Comprehensive Income (Loss)	5,313	3,892	2,757	2,567	2,366	2,874

EXHIBIT 2

Condensed Balance Sheet (\$ in millions)

	McDonalds Corp. (MCD)			Target Corp. (TGT)		
	2017	2016	2015	2017	2016	2015
Cash and Cash Equivalents	2,144	1,064	6,686	1,220	903	600
Short-Term Investments	0	0	0	966	2,617	1,322
Net Receivables	1,719	1,282	1,130	0	0	0
Inventory	51	51	87	7,229	7,483	7,205
Other Current Assets	721	1,820	486	1,017	1,290	2,725
Total Current Assets	4,635	4,218	8,389	10,431	12,293	11,853
Long-Term Investments	945	632	690	0	0	0
PP&E	19,530	18,494	20,112	21,452	21,939	22,578
Other Assets	4,300	3,647	3,815	681	796	1,389
Total Assets	29,409	26,991	33,007	32,565	35,028	35,820
Short-Term Debt	1,710	2,360	1,806	0	0	0
Accounts Payable	805	658	761	6,309	6,454	6,750
Other Current Liabilities	0	0	0	4,746	4,527	3,460
Total Current Liabilities	2,515	3,017	2,567	11,055	10,981	10,210
Long-Term Debt	25,697	22,514	20,986	9,597	10,392	10,992
Other Liabilities	4,041	3,377	3,287	2,384	2,382	2,440
Total Liabilities	32,252	28,909	26,840	23,036	23,755	23,642
Preferred Stock	0	0	0	0	0	0
Common Stock	14	14	14	40	44	46
Treasury Stock	(49,159)	(45,334)	(35,824)	0	0	0
Retained Earnings	42,043	40,214	38,797	5,119	7,124	8,390
Accumulated other comprehensive income (loss)	(1,895)	(2,691)	(2,505)	(555)	(547)	(521)
Other Stockholder Equity	6,153	5,879	5,684	4,925	4,653	4,262
Total Stockholder Equity	(2,843)	(1,918)	6,166	9,529	11,273	12,177
Total Liabilities & Equity	29,409	26,991	33,007	32,565	35,028	35,820

EXHIBIT 3

Stock Information

	McDonalds Corp. (MCD)			Target Corp. (TGT)		
	2017	2016	2015	2017	2016	2015
Average Number of Common Shares Outstanding in millions	1,445	1,445	1,445	484	524	557
Preferred Dividends	0	0	0	0	0	0
Stock Price	139.13	95.92	90.31	52.18	55.42	53.94

EXHIBIT 4

Condensed Income Statement (\$ in millions)

	The Clorox Company (CLX)			Walt Disney Company (DIS)		
	2017	2016	2015	2017	2016	2015
Net Revenue	5,197	5,012	4,920	47,969	48,400	45,645
COGS	2,873	2,752	2,775	26,366	26,094	24,677
Gross Profit	2,324	2,260	2,145	21,603	22,306	20,968
SG&A	705	701	694	7,113	7,616	7,415
Other Operating Expenses	720	704	649	2,420	2,198	2,048
Operating Income	899	855	801	12,070	12,491	11,505
Other Income/ (Expenses)	0	0	0	(74)	444	560
EBIT	899	855	801	11,996	12,935	12,065
Income Tax Expense	287	291	274	3,847	4,418	4,364
Discontinued Operations Income (Loss)	(2)	0	(23)	0	0	0
Net Income (Loss)	610	564	505	8,148	8,517	7,701
Other Comprehensive Income (Loss)	23	(59)	(74)	371	(1,441)	(461)
Comprehensive Income (Loss)	633	505	431	8,519	7,077	7,240
Accumulated Other Comprehensive Income (Loss)	633	505	431	8,205	6,815	6,898

EXHIBIT 5

Condensed Balance Sheet (\$ in millions)

	The Clorox Company (CLX)			Walt Disney Company (DIS)		
	2017	2016	2015	2017	2016	2015
Cash and Cash Equivalents	364	349	332	3,495	4,011	3,714
Short-Term Investments	0	0	0	0	0	0
Net Receivables	492	495	452	7,511	7,887	6,977
Inventory	399	385	335	1,195	1,209	1,367
Other Current Assets	63	63	124	1,623	1,654	2,522
Total Current Assets	1,317	1,292	1,243	13,823	14,760	14,579
Long-Term Investments	0	0	0	2,786	3,724	2,299
PP&E	810	788	799	24,713	23,794	21,906
Other Assets	1,851	1,844	1,581	42,014	37,791	37,934
Total Assets	3,979	3,924	3,623	83,336	80,069	76,718
Short-Term Debt	699	455	344	0	0	0
Accounts Payable	874	900	852	7,704	7,943	6,824
Other Current Liabilities	0	0	27	9,344	6,709	7,386
Total Current Liabilities	1,574	1,355	1,222	17,048	14,653	14,211
Long-Term Debt	1,210	1,556	1,563	16,634	14,340	11,113
Other Liabilities	723	753	735	10,502	9,905	9,065
Total Liabilities	3,507	3,665	3,520	44,183	38,898	34,388
Preferred Stock	0	0	0	0	0	0
Common Stock	138	138	138	31,536	31,197	30,556
Treasury Stock	(2,125)	(2,021)	(1,946)	(55,690)	(47,592)	(41,067)
Retained Earnings	2,123	1,882	1,673	63,167	57,497	51,354
Accumulated other comprehensive income (loss)	(472)	(496)	(437)	(3,069)	(3,462)	(2,106)
Other Stockholder Equity	807	755	674	3,209	3,530	3,593
Total Stockholder Equity	472	258	103	39,153	41,171	42,330
Total Liabilities & Equity	3,979	3,924	3,623	83,336	80,069	76,718

EXHIBIT 6

Stock Information

	The Clorox Company (CLX)			Walt Disney Company (DIS)		
	2017	2016	2015	2017	2016	2015
Average Number of Common Shares Outstanding in millions	138,105	138,105	138,105	1,320	1,389	1,445
Preferred Dividends	0	0	0	0	0	0
Stock Price	119.94	94.34	97.25	90.96	86.83	86.25

To aid in the comparison and analysis of ratio results, fictitious industry averages for selected ratios, with the exception of the P/E ratio, for fiscal years 2015, 2016, and 2017 were provided. (See EXHIBITS 7, 8, and 9 below.) Company specifics were expanded to present the United States Industry Sector as well as the more detailed Industry Group.

EXHIBIT 7

Financial Ratio Industry Averages for Year 2015

	Industry Sector	Industry Group	Debt-to-Equity	Current Ratio	Return on Equity
McDonalds Corp.	Consumer Services	Hotels, Restaurants & Leisure	0.90	0.79	7.32%
Target Corp.	Consumer Discretionary	Retailing	1.11	1.49	17.32%
The Clorox Company	Consumer Staples	Household and Personal Products	7.21	1.05	156.92%
Walt Disney Company	Communication Services	Media & Entertainment	0.90	1.23	9.82%

EXHIBIT 8

Financial Ratio Industry Averages for Year 2016

	Industry Sector	Industry Group	Debt-to-Equity	Current Ratio	Return on Equity
McDonalds Corp.	Consumer Services	Hotels, Restaurants & Leisure	0.68	0.75	3.32%
Target Corp.	Consumer Discretionary	Retailing	1.14	1.46	17.42%
The Clorox Company	Consumer Staples	Household and Personal Products	0.16	0.78	9.72%
Walt Disney Company	Communication Services	Media & Entertainment	0.98	1.23	15.72%

EXHIBIT 9

Financial Ratio Industry Averages for Year 2017

	Industry Sector	Industry Group	Debt-to-Equity	Current Ratio	Return on Equity
McDonalds Corp.	Consumer Services	Hotels, Restaurants & Leisure	0.76	0.74	-5.48%
Target Corp.	Consumer Discretionary	Retailing	1.29	1.45	20.32%
The Clorox Company	Consumer Staples	Household and Personal Products	0.30	1.11	11.02%
Walt Disney Company	Communication Services	Media & Entertainment	1.17	1.57	19.92%

Through Austin's discussion with Jackson, he realized that Jackson was a novice to investing. Furthermore, due to her lack of experience, she was extremely uneasy about investing yet eager to use her inheritance wisely. Therefore, Austin's early professional concern on how to best guide Jackson solidified as one of educational importance, sensible investing, and client retention. He paused for a moment realizing the stakes were high...and considered how to proceed.

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