Passive Investing and Financial Advisory Fees with Rick Ferri – Podcast #109

Podcast #109 Show Notes: Passive Investing and Financial Advisory Fees with Rick Ferri

Our guest today, Rick Ferri, is a financial advisor and an accomplished author of seven books related to investing. I personally consider him the heir apparent to Jack Bogle, although I'm confident that he would utterly reject any sort of comparison like that. He started out his career as a stock broker and gradually figured out that passive investing in index funds was the best way to invest. He is an expert on asset allocation, ETFs, and simple portfolios. He was pretty influential to me early on. His advice to readers and listeners is to make your portfolio as simple as you can. His mantra is simplicity, automation, hibernation. Make it simple, make it automated and just let it do its thing. Don't touch it.

He is an outspoken critic of financial advisory fees. We discuss Assets Under Management fees and what is wrong with them and how you can negotiate lower fees in this episode. AUM fees are the best kind of passive income for advisors. You don't want to be supplying someone else with passive income. As the heir apparent to Jack Bogle, you don't want to miss this interview with Rick Ferri!

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Quote of the Day

Our quote of the day comes from Jack Bogle who said,

> *"Your success in investing will depend in part on your character and guts, and in part on your ability to realize at the height of ebullience and the depth of despair alike that this too shall pass."*

Passive Investing

As a new stockbroker in the 1980s learning the trade, Rick attended Broker Bootcamp with his new employer where he learned how to get people to buy investments.

> *"We had to get on the phone and make 500 phone calls a day trying to get people to buy 1,000 shares of stock. We used to say things like, "Is your husband home? I need to speak to the person who makes the financial decisions in your family." When the husband got on the phone, if he didn't buy something, if he said something like, "I need to talk to my wife about it," you were supposed to say, "Well, John, who wears the pants in your family?" I mean literally this was the stuff that they taught you at Broker Bootcamp for a very big national brokerage firm. I just didn't like any of it. I said, "This is just all wrong," right from the beginning."*

He ended up doing a lot of municipal bonds and managing municipal bond portfolios for clients because he thought that was more ethical. He teamed up with another broker who discovered he wasn't very good at picking stocks either, so he went out and he found money managers to manage his clients' stock portfolios. Rick became the bond manager.

Rick ended up automating the business and running the operations, and was working on his charter Financial Analyst, CFA charter, and his Masters of Science in Finance to learn even more. In doing all this he realized that the active managers really don't know that much. He created a really detailed programmable spreadsheet where he inputted all of the data from all these different money managers they were using, and all the accounts that they were managing, and compared them to the performance of various indexes. Now, remember, this is early 1990s. There wasn't an easy way to do this then. Back then, they didn't even have growth and value indexes. He was trying very hard to figure out whether or not these managers were outperforming, and if they were, who was outperforming, who wasn't. Doing this thing called attribution analysis, he was able to see that the money managers they had hired were underperforming. So they got rid of them and hired more and they underperformed as well. He recognized this was not working for their clients. The bond portfolio was doing okay because all he was doing was a short-term one to 10 year bond ladder. That was working okay using CDs and municipal bonds but the equity side wasn't even close to the performance of the markets.

Then in 1996 he picked up a book by John Bogle called Bogle on Mutual Funds. He had heard him speak at a CFA meeting just after he resigned as the CEO of the Vanguard Group. He started talking about the very thing Rick was seeing.

> *"This guy gets it. This is exactly what I'm seeing. He is talking about exactly, exactly what I'm seeing but he's explaining why. He's talking about Wall Street. He's talking about the problems on Wall Street. He's talking about the fact that managers can't outperform because of their fees and all that, and it's all coming together. I had an aha moment at that point. So I said, "Okay, I have to change the way I'm doing things. I have to go back and tell my clients we're no longer going to be doing these active managers. We are now going to be going into index funds."*

After this, he went to his boss and said to him, "it would be really cool if we went to Vanguard and said to Vanguard, 'We'd like to use all of your index funds and build portfolios for our clients using your index funds.' We would charge the client a reasonable fee, maybe .75%. But it would be all Vanguard index funds because the data shows that indexing outperforms active management."

The boss said to him, "Ferri, who do you think you work for?" Rick said,

> *"'Well, you know I like to think I work for the clients.' Then he said something that made everything crystal clear. Basically something along the lines of he didn't work for the clients, he worked for the shareholders, and that my idea wasn't going to fly. One of the reasons was we weren't going to get any money from Vanguard for using their funds. There were other companies willing to pay us to use their funds. Vanguard would not pay us to use their funds. Right then, dead in the water. I mean, we're not using any Vanguard funds. It didn't matter whether it was in the best interest of the clients because the only people that really mattered, at that level, were the shareholders."*

Pretty telling story as to why you should be passively investing in index funds. Rick finished out his contract at that job and then started his own company, Portfolio Solutions, where he managed index funds for people for a quarter of a percent, not doing tactical asset allocation or anything like that, just simple index funds.

Rick Ferri's Books

His first book was called Serious Money – Straight Talk about Investing for Retirement. You can read it today as a free download. It was an expose of what was going on in the brokerage industry. He started collecting a lot of data once he saw the light about index funds and

> *"wanted to at least quantify in my own mind why I was doing this, and maybe quantify it for future clients so I started collecting a whole lot of data. I mean anything I could get my hands on having to do with performance and index funds, and what's going on on Wall Street, even some inside things having to do with analysts kind of getting paid off to change the ratings on stocks. Things like that, that I actually knew were happening and I collected data. I decided to put it all into a book called Serious Money.*
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> *I said you could divide your money up into serious money and what I call bingo money. Serious money is the money you really need for retirement and you really got to be careful with what you're doing. Then the bingo money you can go around and buy some stocks or do whatever you're going to do. Generally no more than 10% of your portfolio, if not less than that. But the serious money, what should you do with it? So that was what this book was about. What worked was buying a few low-cost index funds in a portfolio, keeping your expenses low, and just maintaining that portfolio for the very long-term and staying the course. That was the whole message of Serious Money: Straight Talk about Investing for Retirement, no more Wall Street talk."*

A little bit cathartic I'm sure for him, coming out of the dark side of the industry, to be able to put out his opinion like that as he started Portfolio Solutions.

After that, he got into the All About Series. All About Index Funds is all about the different indexes, how they're all constructed, how to put a portfolio together using index funds.

After that, the publisher wanted the book, because the market was going down, on how to use index funds to make money even when the stock market goes down. He said, "I don't know how to write that book. I can write a book for you on investment planning and sort of the phases that you go through from the time you start working until the time that you retire and then beyond retirement, and how your portfolio should change based on this lifecycle of investing. We can apply that to index funds." When they went to publish it they changed the title to Protecting Your Wealth in Good Times and Bad, The book is about life strategy planning using index funds.

Next was All About Asset Allocation. He saw a need for a more user-friendly book on asset allocation. It is a book about portfolio management. It is the book you would pick up to see how to put a portfolio together based on your needs. This is one of my favorites. I really enjoyed it. It was probably one of the first five good books I read about investing. It was pretty influential to me early on.

After that book was The ETF Book. Which led to another book called The Power of Passive Investing. This book, is a history book of index investing. Because index investing didn't just start from scratch in the 1970s when John Bogle launched the first index fund. You can go way back and find information about how active managers did versus various indexes all the way back to the 1920s. He collected all of that data together. It was more of a history book about why passive investing, not only has been working recently, but has been working for 100 years for people who have actually been doing it. It gets into factor investing and how indexes have changed. The Power of Passive Investing was basically a history book about passive investing, past, present, and where it is going in the future, which he predicted tremendous growth and, of course, that's what we've had.

Rick was the editor for The Bogleheads' Guide to Retirement Planning, which I wrote a chapter for. Every chapter has a different author. It was a challenging book to edit, trying to make it read like one voice with all those authors but a good one to read if you haven't.

Factor Investing

I asked Rick, “which factors do you think are real and should be invested in? And which of these 500 identified factors out there are just bogus?”

He felt like most people shouldn’t do it. You don’t need it. Certainly, it isn’t necessary to have in your portfolio. It dresses up the portfolio a little bit, with the hope of getting a higher return, but always paying higher fees. That’s one of the big problems of it.

Theoretically, if you take the market and you divide it up into various buckets, some of the buckets have more risk than other buckets. Because those buckets have more risk, they should give you a higher rate of return. You can quantitatively divide the market up 500 different ways to come up with these various buckets. But the buckets that have more risk are expected to give you a higher rate of return because there’s more risk. If you want to magnify that bucket in your portfolio, call it small-cap value, which is a very small part of the stock market. But if you want to magnify that bucket, magnify that risk in your portfolio, then you should get a higher return because you’re taking more risk.

However, you’re also paying more because factor funds are not dirt cheap like a total factor index fund. There are some factor funds out there that are very inexpensive now. So if you’re going to do it, you certainly want to go that direction. You do it in an ETF, if it’s a taxable account, because of the tax benefits of an ETF versus an open-end mutual fund.

You also have to wait a long time. He says, “If you’ve got the time, factors may be the place.” Because you might have to wait 15-20 years before you get a premium return from these factors. They can go into a drought for a very long period of time. You have to make it a lifelong commitment. If you’re not willing to hold onto it for 20 or 25 years, literally a lifetime of investing, then don’t do it to begin with.

Real Estate Investing

What does Rick think about real estate investing outside of publicly traded REITs, such as through individual properties or syndications of apartment complexes or private real estate funds?

He doesn’t really like private real estate funds and has never invested in them. It is very hard to get your money out of a private real estate fund. He would avoid that. You would really have to know who is running it personally. He would not recommend it unless you really know the people who are doing this fund, know what they’re getting into, and you can tie your money up for a long period of time.

To actually do real estate yourself, he said that was fine too if you want to deal with it. You have to to buy the properties, maintain the properties, collect the rents, and all of that. It is a good business to be in but not passive by any stretch of the imagination.

Investing in International Stocks

Does he agree with Jack Bogle that an investor doesn’t need international stocks in their portfolio?

> *“Yes, because you used the word need. No, investors don’t need international stocks in their portfolio. They probably need stocks in their portfolio, equity exposure, but they don’t need international. It does give you a little more diversification. It does give you a hedge against a downturn in the US dollar, because international stock index funds are not hedged against the dollar. So you do have a little bit of a dollar hedge there. But it’s not needed. It can help in the long-term. Of my own portfolio, 30% of my equity is in*

international and 70% is in US. If I didn't have any international stocks would I be worried about it? No. Not one bit."

ETFs vs Traditional Mutual Funds

He essentially wrote the book on ETFs. Many beginning investors wonder if they should invest in ETFs or traditional mutual funds. What would Rick tell them?

It depends on whether you have access to ETFs. A lot of 401K plans are just mutual funds so you don't have access. The second thing is, where is your money being custodied? If you are holding your money at Charles Schwab and you want to buy a Vanguard fund, the commission to buy a Vanguard mutual fund through Charles Schwab can be quite high. But you can buy the ETF for a much, much lower commission. It's the same fund. In other words, at Vanguard the mutual fund and the ETF are actually the same pot of money. It's the same fund, just a different share class. That is another reason you might want to buy ETFs as opposed to funds.

If you are in a taxable account, you probably want to stick with ETFs because they're more tax efficient than mutual funds. The reason for that is because of this creation of redemption, they're actually much more tax efficient. An established ETF doesn't spin off capital gains every year, whereas a mutual fund would. If you're buying something in a taxable account, a lot of times the ETFs, especially on the equity side, the ETFs are the way to do it. There are operational reasons why and tax reasons why you might want to use the structure of an ETF as opposed to the structure of a mutual fund.

I asked him "do you find that is the case, the tax efficiency aspect, is the case even with the Vanguard share classes? Are you slightly more tax efficient by using the ETF versus the traditional fund? Or are you able to flesh out those appreciated shares from the traditional fund via the ETF creation/redemption?"

> *"The bottom line is that with Vanguard and Vanguard only, no other mutual fund company, just Vanguard, the tax efficiency of their mutual funds is the same as the tax efficiency of their ETFs because they are all the same pot of money. There's actually, for the portfolio manager of the Vanguard funds/ETF, they can double tax manage the portfolio. If they have losses in the portfolio and they get redemptions on the mutual fund side, they can sell the stocks when they're at a loss and so the fund itself starts to carry this tax loss carry forward. If they have gains in the fund from stocks, then when they get redemptions on the ETF side they can push out the high cost basis stocks. A little complicated but the bottom line is it's a very tax efficient structure at Vanguard. Vanguard and only Vanguard alone, whether you buy the ETF or the mutual fund you get the same tax efficiency."*

Financial Advisory Fees

We turned to talking about advisory services as lately Rick has been pretty active on Twitter disparaging the AUM model of paying an advisor, paying a percentage of the assets under management. I asked him why he thinks that is a bad model.

He clarified that he doesn't think it is a bad model. He did it for 20 years with a low fee. He feels the fee was appropriate for what they did, talking with clients about what their asset allocation should be, what their tax situation was, creating portfolios of index funds, putting them at Vanguard, or wherever they needed to be, and then managing them. Originally the fee was .25. He thinks that's an appropriate AUM fee for a million dollar account. If it's a five million dollar account it should be less, maybe .2. If it's a 10 million dollar account, it might be .15. Because as the account gets larger, the work that the manager has to do isn't any greater. Now you might have a slightly higher liability, a slightly higher insurance cost, but the manager should be paid for the work that they do.

What he doesn't like about AUM is what he calls a wrap. You have people who are not only doing money management but full comprehensive financial planning. They are asking you to pay them 1% per year for a comprehensive financial plan and to manage your money.

> *"Now, how much does a comprehensive financial plan actually cost? How many times do you do it? Well, it's comprehensive so you only do it once. You don't have to do it every single year. How much does it cost to actually do one? Well, the data out there shows it costs about $3,500 of time for a financial planner to do a financial plan, that is if they charge $250 an hour and it takes them 15 hours to do a comprehensive plan, which is the numbers.*
>
> *How much does it cost to manage an investment portfolio? Well, I know because I did it. I made a good profit on it. About .25 percent per year. You get .25 on a million, that's 2,500. Then 3,500 the first year to do a comprehensive financial plan. Okay, I add that together and now I know I*

went through public schools but to me that came out to $6,000. But they're charging $10,000. Well, what's the other $4,000 for? I don't know. But that's just the first year.

The second year you don't need another comprehensive financial plan. You still have the million dollar portfolio, it maybe went up a little bit. There's going to be maybe some tailoring of the financial plan, call it $1,000. So you got $2,500 fee for managing the portfolio, maybe $1,000 for keeping the financial plan up, and that's being very liberal. So that's $3,500. Well, what's the other $6,500 for? I don't know. Why are you tying these services that are one-off services, that you only do one time, and maybe kind of keep it up a little bit over time, why do you keep charging the client year after year after year for the same service but you're not delivering anything?

This is where my issue comes in. I don't mind the AUM fee for managing the investment portfolio."

The bottom line, we all know why they do it. I think I had an advisor tell me that AUM fees are the best kind of passive income there is. For an advisor. I mean that portfolio gets to be five million dollars and they're paying $50,000 a year for a service that perhaps you can get for $5000. That's pretty darn good passive income.

I asked Rick, is it possible to start the Vanguard of financial advisory firms?

He thinks this is what Betterment and [Wealthfront] are trying to do. They want to try to establish themselves as the Vanguard of the advisory world by automating everything. With Betterment now you could call up and get as-needed advice kind of a la carte that you just pay for. Or you can hire them for .4% to manage the $100,000 portfolio and give you financial advice on your other $10 million. You could have $10 million outside of Betterment, $100,000 with Betterment, pay them .4%

on the $100,000 and have full access to five financial planners at Betterment who will help you with everything you have.

I mean that is democratization of financial planning. Now Schwab has followed suit with their $30 a month offer. They are trying to compete against the Betterment model. This is the way in which advice is going. Can you get good advice for $30/month?

Rick thinks so. 90% of the advice people need is standardized, pretty generic.

Bill Bernstein thinks less than one percent of investors can be successful as do-it-yourselfers, that they would be better off hiring an advisor than managing their own investments. But Rick thinks the world is changing and where that might have been true several years ago, the internet is helping people become better educated.

Reader and Listener Q&A

The Perfect Portfolio

I've noticed among intermediate investors this quest for the perfect portfolio. To these people Rick said,

> *"There is no such thing as the perfect portfolio. There is the best portfolio for you given your situation, but you can never find the perfect portfolio. You can never find the optimal asset allocation. All you're going to do is drive yourself crazy. You're going to keep on adding things, taking things out, trying to find the ideal mix, trying to find negatively correlated asset classes. You're going to go down a lot of rabbit holes. The bottom line is what works is a simple portfolio, something like the three-fund portfolio."*

Flat Fee Advisors

Will we see a significant increase in advisors using flat-fee and/or hourly billing? It seems too lucrative for advisors to give up the AUM model.

> *"Yeah, they're going to come in kicking and screaming. Remember what happened when Jack Bogle introduced the first index fund. It was called Bogle's folly. In fact, one of the fund companies called it un-American. The fund company was making too much money. They wanted to crush this idea of indexing right at the beginning. It took many years, I mean it literally took 25 years before indexing actually caught on. That was 1976 when the first index fund was launched. I think it took 12 years to get the first billion dollars into index funds. Now, I don't know how many trillions of dollars are in index funds. But the bottom line is it's an exponential curve.*
>
> *I'll give you another example. The commissions, there used to be fixed commission rates at brokerage firms. All brokerage firms charged some ungodly fee like two dollars per share to trade stock. Then they had eighth of a point up and down. I mean brokerage firms were making an incredible amount of money on commissions until they did away with fixed commission rates. Then Charles Schwab comes out with discount brokerage. Now you can trade stocks, trade in ETFs for almost zero. I mean fractions of a penny.*
>
> *What about advisor fees? It's the last bastion of gluttony in the investment industry. I mean mutual fund fees have come way down to almost nothing. Indexing has driven even active fund fees down, and indexing fees are almost at nothing. Trading costs are almost at nothing. Where the fat is now in this industry is in advisor fees, and it's being targeted. So advisors can hold on to what they have for only so long. As investors become more educated through the internet, I think advisors are going to be forced to look at other models.*

> *Either discounting their fees if it is AUM, or doing some sort of a AUM with a cap maximum fee, or doing flat fee, but something is changing.*
>
> *The ones who are doing one percent or higher AUM right now are going to give it up kicking and screaming, but eventually the world is going to slowly push them out like they've pushed out two dollar commission rates per share and like the world has pushed out one and a half percent mutual fund fees."*

Bogleheads Podcast

Rick is the producer of the [Bogleheads Podcast.] One listener wanted to know if he would entertain the idea of bimonthly podcast instead of monthly. But Rick said no, monthly was enough of a commitment for him.

The Boglesheads podcast is funded by the non-profit organization, the John C. Bogle Center for Financial Literacy, which pays the $100 per year for Rick to do podcast hosting. He spends a day interviewing a special guest. He had John Bogle on as his first guest. Then had David Blitzer, who is now the retiring chairman of the S&P Index Committee and that was fascinating. He has had a lot of other guests, Gus Sauter and Christine Bense and so forth. He just talks with them for an hour and ask questions and gets some really good insight. Check out that podcast if you haven't already.

Asset Allocation

What is Rick's asset allocation by percentage?

His money is coming in from the sale of his business currently so it is mostly in cash. But when it is invested he is going to be 80% equity and 20% fixed income. He has a pension from both the military and a previous employer. The fixed income portion of his portfolio, only a small portion of it, basically two years worth of living expenses are in a short-term bond index fund. The other portion of his fixed income is in a preferred stock index fund, PFFD. The reason for that is because this is taxable money and preferred stocks pay a dividend, which is actually a tax efficient dividend, and it's at a relatively high rate relative to corporate bonds. It is really a unique asset class.

> *"I used to manage individual portfolios of preferred stocks for clients. They did very well so I really understand the preferred stock market. So a pretty good portion of the fixed income portion of my portfolio is in a preferred stock index fund. The rest of it is in VTI and the Vanguard Total International fund. I am thinking about putting some money in a very deep factor fund through Alpha Architect, Wes Gray. Only because I think it would be kind of my bingo money. I like Wes. I like his company. I've been to Alpha Architect many times. I might put some crazy money in one of their deep factor funds."*

He is definitely practicing what he preaches with simplicity there. That's a pretty simple portfolio.

Ferri Investment Solutions

Rick and his wife spent a few years living in an RV and traveling around the states. But when that adventure was over he settled in Texas and started Ferri Investment Solutions.

He is charging people by the hour for investment review and investment recommendations. It could be as little as a half hour of time. He schedules a session in the morning and a session in the afternoon.

People send him their information and he spends about an hour with them on the phone. He charges $500 for what he calls a portfolio second opinion.

> *"Then the people, who are generally do-it-yourself investors, will go out and take my recommendations perhaps and do it on their own. Generally, most of it is just a one-time help you out when you need it, send you on your way. If you need me again, just schedule another hour and talk with me again. That's my whole business model. I really enjoy talking to the people. I really enjoy looking at all these different types of portfolios and what people have done, and helping them out when they need to be helped."*

I think that is perfect for a lot of people. But even better he also offers to negotiate your fees should you not want to manage your money yourself.

> *"Now I've had several people who have come to me and say, "I don't want to do this myself. I want somebody else to do it." I will go to an IRA firm, a money management company, and say to them, "I have a client who has five million dollars. This is what the portfolio is going to look like when it's done because I've already redone everything. So the taxable account is going to look like this. The tax exempt account is going to look like that. Here's the portfolio. It's five million dollars. What fee are you going to charge my client?"*

He has been able to negotiate fees of .25% and less for full portfolio management. The advisor will take the portfolio Rick put together and implement the changes that he worked on and manage it on an ongoing basis, do rebalancing when it needs to be done, do tax management, send the client reports, be the administrative person for the client so if they needed money, doing required minimum distribution and everything, the full gamut. He is able to negotiate the lower fees because he knows how much work it will take them because he did it for 20 years.

What a wonderful service. Not only do you get somebody to help you design the plan, the portfolio, but you get somebody who knows what they're doing to negotiate the fees for you. I mean that is awesome.

Rick's parting advice for listeners is to keep it simple. The simpler you make things, the better. Use all your tax efficient accounts that you can use, cash balance accounts, whatever it is that your CPAs and advisors are telling you to set up to save on taxes every year. But make it as simple as you can, putting it in something very simple, a three-fund portfolio, something that you don't have to mess with, and just keep on doing it over and over and over again. Simplicity, automation, hibernation.

> *"Make it simple, make it automated, and just let it do its thing. Don't touch it. That's the best advice I can give."*

Regarding your portfolio, make it simple, make it automated, and just let it do its thing. Don't touch it. That's the best financial advice I can give. Simplicity, automation, hibernation. – Rick Ferri

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Ending

I loved interviewing Rick. He has been a huge influence in my life financially, certainly has influenced my own portfolio. I'm really supportive of what he's doing with his new service. Check that out if you are interested.

Full Transcription

Intro: This is The White Coat Investor Podcast, where we help those who wear the white coat get a fair shake on Wall Street. We've been helping doctors and other high-income professionals stop doing dumb things with their money since 2011. Here's your host, Dr. Jim Dahle.

WCI: Welcome to White Coat Investor Podcast number 109: Passive Investing and Financial Advisory Fees with Rick Ferri. Creighton University believes in equipping physicians for success in the exam room, the operating room, and the boardroom. If you want to sharpen your business acumen, deepen your leadership understanding, and earn your seat at the table, Creighton's Executive Healthcare MBA is for you. Specifically tailored to busy physicians, advanced clinicians, or working healthcare executives, our program blends the richness of on-campus and the flexibility of online learning. Earn a Creighton University Executive MBA in 18 months, 45 credit hours, and four, four-day on-campus residencies. Learn in a deeply collaborative, peer-to-peer cohort and elevate your expertise. Visit www.creighton.edu/CHEE to learn more.

WCI: Thanks so much for what you do. Your work is oftentimes thankless and frequently difficult. When it's not difficult, it can be mundane or soul-crushing as you try to figure out why the EMR has crashed yet again. I want to say thank you to you today for what you do. Our quote of the day comes from Jack Bogle who said, "Your success in investing will depend in part on your character and guts, and in part on your ability to realize at the height of ebullience and the depth of despair alike that this too shall pass."

WCI: If you haven’t had a chance to do your initial financial education, I recommend our Fire Your Financial Advisor course. This is a seven to eight hour online course, mostly video and screencasting, where I take you through writing your own financial plan, and give you a framework on which to hang all the information you learn about in the podcast and on the blog, et cetera. It costs $499, which is obviously more expensive than books and reading blog posts and participating on forums. That is another way in which you can write your own written financial plan. However, it will likely take you a very long time, if you are anything like me, and a lot of effort. This is essentially a shortcut to that.

WCI: If your time is extremely valuable, you may find that it’s worth paying 499 in order for me to shortcut that process for you. Certainly, it’s dramatically cheaper than hiring a financial advisor, who’s going to charge you two to five thousand dollars to put together a written financial plan. And so consider taking that. Fire Your Financial Advisor is what it’s called. There are links to it on the website. It comes with a seven day, no questions asked, 100% money-back guarantee. There is no risk to you to try it. Go ahead and take a look. If you think it’s not right for you, just email us and we’ll give you your money back within seven days.

WCI: We have a very special guest today I’m excited to have on. We have Rick Ferri, CFA. Rick is a Marine. There’s no such thing as a retired Marine or an ex-Marine it turns out, so he is a Marine. He was an aviator with the Marines as I recall. He’s a financial advisor and he’s an accomplished author of seven books related to investing. I personally consider him the heir apparent to Jack Bogle, although I’m confident that he would utterly reject any sort of comparison like that. Let’s bring him onto the podcast. Welcome to the show, Rick. We’re glad to have you on the White Coat Investor Podcast.

Rick Ferri: It’s a pleasure to be here. Could I address you as Jim or should I use Doctor?

WCI: Please don’t call me Doctor on the podcast. I think that would be entirely too uptight in that case. You can call me whatever you like and I will answer.

Rick Ferri: Well, we’ve known each other for a long time so I feel we’re on a first name basis.

WCI: Oh, good. Let’s do that then. I have read over half your books. I don’t think I have ever heard your story, though. Can you tell us your story from then beginning, including things like what your family was like, and what your upbringing was like, and tell us about your education and your time in the military?

Rick Ferri: Sure. I’ll try to keep it brief. I was born in Rhode Island. My father was an electrician. He worked for the Department of the Navy. My mother was a housekeeper, worked at home for the most part. I went to public schools. I always had an interest in business, though. I started all kinds of small businesses when I was a young kid. I used to sell little ice pops on the side of the road. I used to have this thing called a carnival, Kooky Carnival we called it, where we ran all kinds of little games in the backyard and made a little money there. So I always had an interest in business, and finance, and money.

Rick Ferri: Decided later on when I was in high school, I ended up starting a flea market antique business. I would go around and buy various things at auctions and flea markets. I would go to another flea market and sell them and I was making really good money. In fact, in college, I literally paid for college by doing that. So I was always interested in profitability and so forth. I ended up going to college and studying business. At the time there was a business administration degree, which I got from the University of Rhode Island with a concentration also in entrepreneurial studies, because I always thought that I’d like to run my own business someday. That was 1980 when I graduated from the

University of Rhode Island. I don’t know if you recall or even if you were around much back then, but-

WCI: I was a good five years old. I’m sure I was paying attention.

Rick Ferri: Okay. Interest rates were something about 15%. The unemployment rate was just about the same. We were in the middle of a really bad downturn in the economy, a really serious downturn. Pretty much there wasn’t much opportunity to go out and get a good paying job. Or any job, actually, at that point. A friend of mine had gone in the military out of high school. He had a great experience. I was an Eagle Scout. I was always interested in perhaps doing that. So I decided going out of college I looked at the various services and decided on going into the Marine Corps. I was the few, the proud.

Rick Ferri: Anyway, when I was doing that they asked me if I wanted to fly jets or if I wanted to fly planes. I thought maybe you had to have some sort of an advanced degree in aviation or engineering or something to be a pilot. But it turns out you didn’t have to. You just had to be able to pass the exams. They were fairly mathematical and a lot of spatial orientation type things that I did fine in. Next thing I know, I took the eye exam and all the medical stuff, as you know from your career. I ended up going to flight school after finishing Officer Candidate School and then something in the Marine Corps called The Basic School.

Rick Ferri: They sent me down to Pensacola, Florida. Start flying. That led to flying jets, advanced training down in Texas, where I met my wife. I always like to say the Marine Corps issued me a wife down in Texas. Which, by the way, where I live now because if your wife is from Texas eventually you’ll be from Texas. That’s what happened. I did two tours overseas. I was a pilot. I also did a tour in the infantry. Flew off aircraft carriers flying A-6 Intruders. That was great for about eight years.

Rick Ferri: But one time when I came back from overseas, we had two children and was one on the way. When we landed the airplane and we all got out of the cockpit from being away for six or seven months and we walked into the squadron, my wife was sitting there pregnant and pointing at me, saying to my two boys, “That’s your father.” My oldest boy recognized me. He was about, I’d say four and a half at the time, so he came running up to me. But my two-year-old had absolutely no idea who I was. He hid behind my wife. He kind of looked at me with these eyes that I never want to see again, from any of my children.

Rick Ferri: I kind of at that point said, “I’ve done this enough.” There wasn’t a war going on at the time. “I don’t need to do this anymore.” I decided at that point to get out of the military. I went into the reserves and finished my 20 years in the reserves, but I decided that I was going to get off of active duty and do something else. That’s what took me to Wall Street, if you will. Because when I started looking for employment I was really interested in the stock market, and then business, and so forth. I ended up going to work at a company called Kidder Peabody. They sent me to this place called Michigan, where I’ve never been before.

Rick Ferri: We ended up moving up there and I went to work for Kidder Peabody as a typical stockbroker and was learning the trade. I went to Broker Bootcamp. Literally, that’s what it was called, where you study how to sell things. In fact, the bible that we studied was The Art of Selling Intangibles by a fellow by the name of LeRoy Gross, who has now passed away but he was a broker for Merrill Lynch for many years, very successful. He wrote a book all about how to get people to buy investments. Of course, the big thing was don’t promise them a profit but make it very appealing to them that there’s going to be a big profit in there for them. That was the sort of how you sell things, and sell the sizzle, not the steak. Went through this whole course about how to sell investments and intangibles.

Rick Ferri: We had to get on the phone and make 500 phone calls a day trying to get people to buy 1,000 shares of stock. We used to say things like, well and we used to get the man on the phone, I mean literally this was the 1980s. “Is your husband home? I need to speak to the person who makes the financial decisions in your family.” When the husband got on the phone if he didn’t buy something we were supposed … If he said something like, “I need to talk to my wife about it,” you were supposed to say, “Well, John, who wears the pants in your family?” I mean literally, this was the stuff that they taught you at Broker Bootcamp for a very big national brokerage firm. I just didn’t like any of it. I said, “This is just all wrong,” right from the beginning. So I-

WCI: Didn’t really vibe with the code of ethics in the military or the Scout Law, did it?

Rick Ferri: No, it did not. It was way, way off base. So this is it, right? Anyway, I ended up doing a lot of municipal bonds and I ended up managing municipal bond portfolios for clients because I thought that was more ethical. I really didn’t know much about stocks. So that was okay. I ended up teaming up with another broker who actually was a physician. He had left medicine and he decided he was going to become a broker. He went to work for Merrill Lynch and then he ended up at Kidder Peabody. What he discovered was he wasn’t very good at picking stocks either, so he went out and he found money managers to manage his clients’ stock portfolios. I became the bond manager, so I was managing the clients’ bond portfolios.

Rick Ferri: Then I ended up automating the business and sort of running the operations, and was working on my charter Financial Analyst, CFA charter, because that’s what all the money managers had. I got the CFA charter and then I started working on my Master’s of Science in Finance to learn even more. As I’m doing all this I’m realizing that the active managers really don’t know that much. I mean it’s pretty standard across the playing field out there what you really can find out about various companies to outperform the market. One thing I did was I created a really detailed 100,000 line computer program in an old spreadsheet program called Quattro Pro. I’m dating myself again.

Rick Ferri: But it was a programmable spreadsheet program where I inputted all of the data from all these different money managers that we were using, and all the accounts that we were managing, and comparing them to the performance of various indexes. Now remember, this is maybe early 1990s. There wasn’t an easy way to do this. Now it’s much easier, but back then there wasn’t. Back then, they didn’t even have growth and value indexes. That was just new, basically, in about the mid-1990s. I was trying very hard to figure out whether or not these managers were outperforming, and if they were, who was outperforming, who wasn’t, doing this thing called attribution analysis. I’m sorry if I’m dragging on here.

Rick Ferri: But by doing that, I was able to see that these money managers that we’re hiring are not doing very well. In fact, they’re all underperforming. So we got to get rid of these managers and hire new managers, which we did and guess what, they all underperformed. This was a trend. I’m looking at this going, “This is just not working for our clients.” The bond portfolio was doing okay because all I was doing was a short-term one to 10 year bond ladder. That was working okay, using CDs and municipal bonds, and so fine. But the equity side wasn’t even close to the performance of the markets. I was really frustrated by this.

Rick Ferri: We ended up moving the show, if you will, from Kidder Peabody to Smith Barney because Kidder Peabody ran into some problems in 1994 with mortgage trading and CMOs. Long story there, and they ended up breaking up and being sold to

PaineWebber. But during that period of time, I went to Smith Barney with my business partner. Again, Smith Barney had the premier money management selection program where they would go out and they would do all of this analysis. These PhDs and CFAs would analyze all these stock managers and come up with the recommendations for our clients to use. We would use those stock managers and I was continuing to manage the bond portfolio.

Rick Ferri: Anyway, I continued to do my analysis on the performance of those stock managers that were selected by these very educated and smart people. Well, guess what, those managers underperformed by about the same as the managers we were using at Kidder Peabody, so nothing changed. I was very frustrated and I said, “This is terrible. Maybe I’m in the wrong business.” Then in 1996 I picked up a book by a fellow by the name of John Bogle. It was the only book I had not read. I’d read every single book at Barnes and Nobel. You name it, I’ve read it. Anyway, I picked up this book called Bogle on Mutual Funds. I had heard him speak at a CFA meeting. He had just resigned as the CEO of the Vanguard Group. He was the founder of the Vanguard Group. He resigned because he had a heart problem. He ended up having a heart transplant.

Rick Ferri: The very speech that he gave after he had this heart transplant in 1996, I was there. I believe it was in Atlanta. I listened to him and he starts talking about this. I’m sitting there listening to him saying, “Where is he getting this information from because this is exactly what I’m seeing? I’m going to have to read his book.” So I did finally go get his book. I remember when I was reading it. It was in October, late October of 1996. I had taken my children to a house of horrors because it was Halloween. I was sitting in the car waiting for them go through the house of horrors. In the background I heard this chainsaw … and people screaming …

Rick Ferri: And I’m reading this book and I’m having my own horror show. I mean I’m screaming reading this book saying, "This guy gets it. This is exactly what I'm seeing. He is talking about exactly, exactly what I'm seeing but he's explaining why." He's talking about Wall Street. He's talking about the problems on Wall Street. He's talking about the fact that managers can't outperform because of their fees and all that, and it's all coming together. I had an aha moment at that point. So I said, "Okay, I have to change the way I'm doing things. I have to go back and tell my clients we're no longer going to be doing these active managers. We are now going to be going into index funds." Which at the time, there weren't any except for a couple of ETFs, one of them called Spyders, S-P-Y that was available to me. Other than that I was in the brokerage world. You didn't have access to Vanguard Funds. Any time you want to interrupt me, go ahead.

WCI: No, you are progressing perfectly through the questions I'm going to ask you. So I'm not going to interrupt until you go way off track.

Rick Ferri: Oh, okay. So anyway, so all we had was Spyders, S-P-Y and Middies, which were S&P MidCap. I had no other access. I went to my boss at the time, Jamie Dimond. Jamie was the President of Smith Barney. He was a very approachable person. I had a good relationship with him. He knew who I was. He was a very nice guy and he was a very straight shooter. I mean, Jamie was a no-nonsense guy. He wasn't going to try to BS you. He was going to be a very straight shooter. I went to him and I said to him, "Jamie, what would be really cool at Smith Barney if we did this, would be to go to Vanguard and say to Vanguard, 'We'd like to use all of your index funds and build portfolios here at Smith Barney using your index funds.' We would charge the client a, I don't know, a reasonable fee, maybe .75%. I mean, call it one percent. But it would be all Vanguard index funds because the data shows that indexing outperforms active management."

Rick Ferri: I'm telling them this and he's looking at me. He says to me, "Ferri, who do you think you work for?" I said, “Well, Jamie, you know I like to think I work for the clients.” Then he said something that made everything crystal clear, and I won’t repeat it on your podcast. But it basically something along the lines of he didn’t work for the clients, he worked for the shareholders, and that my idea wasn’t going to fly at Smith Barney. One of the reasons was Smith Barney wasn’t going to get any money from Vanguard for using their funds. There were other companies willing to pay us to use their funds. Vanguard would not pay us to use their funds. Right then, dead in the water. I mean, we’re not using any Vanguard funds. It didn’t matter whether it was in the best interest of the clients because the only people that really mattered, at that level, were the shareholders of Smith Barney, meaning the people who own the stock, not the clients of Smith Barney.

Rick Ferri: He made it very clear to me and I said, “Well, Jamie, I really think this should be done.” He kind of said, “You know what, good luck. You’re not going to be able to do it here. Good luck.” I knew at that point that I had to leave, but I had a contract. This was around 1997, so for the next two years I planned my escape from Wall Street. I planned this company that would manage money using low-cost index funds, primarily Vanguard funds. I left two years later when my contract was over, and I started my first investment company called Portfolio Solutions. I charged a very low fee. I only charged a quarter of a percent per year to manage portfolios of basically Vanguard funds. Some Dimensional Fund Advisors, DFA funds were including in that, and a couple of cats and dogs, ETFs that came along.

Rick Ferri: I put these very simple portfolios together for people. I charged them a quarter of a percent. We custodied at Schwab and I managed the portfolios. I was doing it out of my living room, much the way I’m doing things right now. It was good. I mean, and I started bringing on clients and building up my assets. But then something happened. A fellow by the

name of Jonathan Clements, who worked for the Wall Street Journal, around 2001 got ahold of something that found out that I was doing this. He called me on the phone, and I'll never forget it. I don't know if you've ever talked to Jonathan or not, but-
WCI: Yeah, we had him on the podcast not long ago.

Rick Ferri: Okay. Great guy. "Hey, Rick, this is Jonathan Clements of the Wall Street Journal." I said, "No it isn't. Come on. Who is this?" Right? "No, this is Jonathan Clements of the Wall Street Journal. I hear you're managing money using index funds for a quarter of a percent per year." I said, "Yeah, that's right." He goes, "Yeah, I want to talk to you about that." So we did. Next thing I know it's in the Wall Street Journal. I mean, half-page article about this guy from Troy, Michigan, managing index funds for people for a quarter of a percent, custodying at Schwab, and not doing tactical asset allocation or anything like that, just simple index funds. He thought it was great.

Rick Ferri: Oh my God, the phone started ringing off the hook. I mean, off the hook. I was like, "Uh-oh. We're in trouble." We ended up bringing on a junior business partner who was a guy who I was mentoring, who had went to the college that I taught at. I was teaching some finance courses and he had gone to the college. Although, he didn't take any of my courses. But anyway, I was mentoring him. His business wasn't really doing anything, but he had the bug about being a money manager. I brought him in.

Rick Ferri: I said, "Look. I really can't pay you because I'm not making enough money, but I can sort of give you equity in the company." He agreed to that. That was it. The company just exploded. We went from, oh, maybe 50 million in assets under management to a billion in assets under management over the next 10 years. Ultimately, by the time I sold the company it was 1.5 billion in assets. But things changed, unfortunately, in the last five years. Anyway, that's the story of me. I did write a lot of books along the way and that really helped. I got on the-

WCI: Yeah, we’re going to get into the books. Before we leave Portfolio Solutions, you said some things have changed. What kind of resulted in you deciding to separate from Portfolio Solutions? And any details you care to go into about the changes.

Rick Ferri: Sure. I don’t want to get into too many details because there was two court cases involved in it, believe it or not, unfortunately. My business partner who I brought on, my early one, was great for the first 10 years and then decided … he made some decisions about the company. I moved down to Texas from Michigan after about year 12. I want to be very careful about what I say here to make sure I don’t get it wrong, but it’s all public knowledge. When I came down to Texas, I basically opened up another office down here to do research and to help clients, but all of the operations were handled up in Michigan. My former partner was the one who was running that.

Rick Ferri: He was having some difficulties operationally because I was the managing partner and I was down in Texas, so I gave him management control. I said, “Okay. Here, I’ll give you management control of the company.” I’ll tell you, that was lesson number one learning when you run a small business is never give up management control. That led to a lot of problems. It led to a problem, number one was he decided he wanted to raise the fee, which I was adamantly against. I was always at a quarter of a percent and I wanted to stay there. He wanted to raise the fee. He had permission, according to the operating agreement, which I kind of wasn’t really paying attention to. But the managing partner had permission to raise fees. He raised fees on the clients, which really was a bad idea. That really led to a falling out that I had with the first partner.

Rick Ferri: Well come along, oh, again, I'll make a short story long here. He decided that I was getting to be too much of a problem for the company and that I needed to go. He tried to freeze me out of the company as a partner and basically put me out. That led to arbitration, which I won, which then put him out. Now, you would think that Rick would be smart about this and I'd be back in control, but I didn't do that. Another lesson learned. I brought on another business partner, who happened to be a private equity person, who we did not hit it off. I mean it was a big mistake on my part. He decided that he was going to change a lot of things in the company, including what we were offering to clients, and trying to upsell people on different things.

Rick Ferri: I completely, it was completely against my culture. I didn't realize this initially when I brought him on. It all sounded good. Man, it really sounded great what he was talking about we could do with the company, go international and everything else. Anyway, that, he ended up decided that I didn't need to be in the company either. So he froze me out of the company. Again, I was like … Now we had a little bit different situation on management control there. We actually had joint management control, but he was still able to go to the four corners of the operating agreement and freeze me out. We ended up in arbitration again, so two arbitrations. But this time, I won that one too.

Rick Ferri: So I won the first one and I won the second one, but when I won the second one I opted to be bought out because I was 60 years old, I had most of my equity in the company, and I needed to have a liquidity event so that I could be financially secure. I opted, after winning that arbitration, to be bought out. That buyout is taking effect right now. I was paid damages. I was also given a very short non-compete, so I was able to now open up another business. That's what happened. I guess the thing I feel really bad about is I kind of left the clients hanging in many ways, because they didn't know anything that was going on. I couldn't talk about it. I can only talk about it now.

Rick Ferri: So for a few years there, they didn't know what was going on. They just knew that I wasn't there anymore. They didn't even know that I wasn't making the investment decisions in the account anymore. They didn't know that. So there was a lot of problems there, I think. But it's all behind me and we're going forward now.

WCI: Let's get back to the books here. I believe you've written seven, if we can include the one you edited for the Bogleheads. I don't know which one was first actually. Was Protecting Your Wealth first or All About Index Funds first?

Rick Ferri: No. There was actually a self-published book called Serious Money.

WCI: Oh, Serious Money was the first one. All right.

Rick Ferri: That's right.

WCI: So let's talk about that one and its message.

Rick Ferri: Well, that was my expose of what was going on in the brokerage industry. While I was there, after I had my epiphany reading John Bogle's book, and once I talked with Jamie Dimon about "this is the way we need to go", and realizing that I was going to go this direction, I wanted to at least quantify in my own mind why I was doing this, and maybe quantify it for future clients so I started collecting a whole lot of data. I mean anything I could get my hands on having to do with performance and index funds, and what's going on on Wall Street, even some inside baseball things having to do with analysts kind of getting paid off to change the ratings on stocks. Things like that, that I actually knew was happening and I collected data on. I decided to put it all into a book called Serious Money.

Rick Ferri: I said you could divide your money up into serious money and what I call bingo money. Serious money is the money you really need for retirement and you really got to be careful with what you're doing. Then the bingo money you can go around and buy some stocks or do whatever you're going to do. Generally no more than 10% of your portfolio, if less than that. But the serious money, what should you do with it? So that was what this book was about. Forget about the brokerage firms. Forget about buying the latest hot stock. Forget about jumping from this trend to that trend or market timing. None of that worked. What worked was buying a few low-cost index funds in a portfolio, keeping your expenses low, and just maintaining that portfolio for the very long-term and stay the course. That was the whole message of Serious Money: Straight Talk about Investing for Retirement, no more Wall Street talk.

Rick Ferri: I published that book in 1999, the month that I left the brokerage industry. The next month the publisher went out of business. Next thing I know on my doorstep I have like 2,000 books show up on my doorstep. I ended up giving most of them away, giving them to various people. I think I sold a few copies. But that's what happened. That was that book.

WCI: A little bit cathartic, I think, coming out of the dark side of the industry to be able to put out your opinion like that as you start Portfolio Solutions, huh?
Rick Ferri: Yeah. Apparently the office manager of the Smith Barney office that I was at, as soon as I published this book they got a copy of it. He had an office meeting. He had all his brokers come in. He basically told them all, "This is the book. Do not let your clients read this book. This is all a bunch of lies," on and on and on. "Rick is this. Rick is that." Blah blah blah blah blah blah. "Now go out and all the Rick's clients I want you to just sabotage them and make sure that he doesn't get any." Well, that didn't happen. Most of the clients came with me. But yeah, it was …

Rick Ferri: It's kind of funny because at the same year I

received my Master’s of Science in Finance degree from an accounting college called Walsh College in Troy. At the graduation ceremony when I was getting my degree, I didn’t know this was going to happen but the president of the college is giving his speech. The next thing you know he pulls out my book. He says, “This is the kind of quality of work we put out here at Walsh College. Everyone should read this book.” Anyway, like okay.
WCI: That’s always nice, to get that sort of endorsement.

Rick Ferri: Yeah. That was nice. Anyway-

WCI: Then you got into this All About series, the All About Index Funds, the All About Asset Allocation. That was actually my introduction to you, was All About Asset Allocation. You seemed to enjoy the book writing and were knocking one out every couple of years at that point, were you?

Rick Ferri: I was. What happened was I got a call from McGraw-Hill out of the blue. They said, “We’d like you to write a book about index fund investing.” I said, “I can do that.” Basically the next day I already had an outline written and a book proposal done. I mean, I was ready to go. I sent it to them. They said, “Okay. We’ll accept it.” Then I wrote book and they published the book. It was all about index funds, all about the different indexes, how they’re all constructed, how to put a portfolio together using index funds. I think this was 2002, I want to say. That went well. I mean, the book sold.

Rick Ferri: Then they wanted the book, because the market was going down, they wanted the book on how to use index funds to make money even when the stock market goes down. I said, “I don’t know how to write that book.” I mean, I have no idea. I said, “I can write a book for you on investment planning and sort of the phases that you go through from the time you leave college until the time you … The time you start working, anyway, until the time that you retire and then beyond retirement, and how your portfolio should change based on, it’s this lifecycle of investing. We can apply that to index funds.” They said, “Okay, fine.” So I wrote that book and I turned it in. It was like Lifestyle Investing or Lifecycle Investing or whatever.

Rick Ferri: When they went to publish it they changed the title to Protecting Your Wealth in Good Times and Bad, which was a better title than what they originally had. Because they wanted to stick this title on there, How To Make Money With Index Funds Even When The Market Goes Down. The wanted this type of book out there. Just the title. They didn’t care what was in it. Did not care what was in the book, they just wanted to sell the title. We compromised on Protecting Your Wealth, but that’s not what the book was about. I mean, the book was about this life strategy planning using index funds. It was a very good book. Some people say it was my best book, if not one of the best books anyway. But it never got off the ground.

Rick Ferri: So after three months they pulled the book, because the market turned around and went back up. They didn’t need a book on protecting your wealth anymore. It takes about six to eight months before you actually get a book out through the publishers. The market had turned then, it was now going back up. So this books comes out with the title that they wanted, and they didn’t want the book anymore. So anyway, so that was kind of a disaster but it was still a good book.

Rick Ferri: Then I proposed a book. I said, “Look. What’s needed out there is a book on asset allocation. Basically, there aren’t many good books on asset allocation.” Rob Gibson had a book. But there was only really one or two books on asset … “They need a more user-friendly book on asset allocation. Let me write that.” So they did. That’s how I wrote All About Asset Allocation. Which probably sold 100,000 copies. It’s done very well. It’s in the second edition. I’ll be doing a third edition next year, I hope, if the publisher allows me to. That was the next book.

Rick Ferri: Then, now you've got a successful book which means other publishers are interested in you. So Wiley came to me and asked me if I wanted to write a book about exchange-traded funds. I had to go to McGraw-Hill and say to them, "I've been approached by another publisher to write a book on ETFs." They have the right of first refusal at McGraw-Hill. Apparently, somebody else was writing a book for them on ETFs. The said, "ETFs are such a small market, that's not going to be a big book." Right? This was back in the early 2005, 2006 when ETFs had only a little bit of money in it. So I said, "Okay, fine." So they released me and I was able to go to Wiley and I did the ETF book, which has been a really big seller. In fact, I'm going to be doing an update on it this summer. So I caught the wave on that book and that was good. I've done two editions so far.

Rick Ferri: That led to another book called The Power of Passive Investing. This book, I wanted to do a history book of index investing. Because index investing didn't just start from scratch in the 1970s when John Bogle launched the first index fund. I mean you can go way back and you can find information about how active managers did versus various indexes all the way back to the 1920s. So I collected all of this data together. It was more of a history book about why passive investing, not only has been working recently, but has been working for 100 years for people who have actually been doing it. I wrote this book called The Power of Passive Investing, which I thought was probably my best well-written book, this history book. It gets into factor investing and how indexes have changed and so forth.

Rick Ferri: So The Power of Passive Investing was basically a history book about passive investing, past, present, and where the future, where it's going. Which I predicted tremendous growth and, of course, that's what we've had. That was what that book was about. It really wasn't about portfolio management. It's not the book you would pick up to say, "How do I put a portfolio together based on my needs?” That’s really not that book.

WCI: That one’s All About Asset Allocation.

Rick Ferri: Yeah, exactly.

WCI: Yeah, which-

Rick Ferri: Then there was the … Oh, go ahead. Sorry.

WCI: … which was one of my favorites. I mean I really enjoyed that one. It was probably one of the first five good books I read about investing. It was pretty influential to me early on. It’s interesting, as I looked back through it in preparation for this, I found a recommendation in there for another book in the All About series called All About Hedge Funds. It came at the end of a long section of the book about how you thought hedge funds were pretty much not worth investing in. I’m curious if there was any pressure put on you to include that recommendation in the book.

Rick Ferri: Yes. There certainly was. I mean they wanted me to include as many of the All About series of books that I could get in there. So what I think I did with that is, and I don’t believe you should buy hedge funds, but if you are going to buy them, at least learn about them. Here, here’s a book that you can read, All About Hedge Funds.
WCI: Now when you went to get involved with The Bogleheads’ Guide to Retirement Planning, I mean this is a book I wrote a chapter for. I think every chapter had a different author. It must have been like herding cats. What was that experience like to be an editor for that Bogleheads’ Guide?

Rick Ferri: It was like herding cats. Yeah. I wrote the introduction on the book, that was my contribution. Plus I was one of the editors along with Laura Dogu, and Mel, and Taylor, also. We had to do an awful lot of rewriting on some of the chapters because it’s not just the information that we got in, it’s also the style of writing of each chapter author. We wanted to make it smoother, as far as the voice, so it wouldn’t be so jumpy. You write a certain way, somebody else writes a certain way, somebody else writes a certain way. We didn’t want it to read like an academic journal, we wanted it to read like a book. So even though we took all the same concepts and all the paragraphs said the same thing, Laura and I spent an awful lot of time kind of rewriting what the chapters were so that there would be one voice.

Rick Ferri: I remember one comment that Laura made. She said … One of the authors put a comma after like every three words. It was thousands, thousands of commas. So we had to flip sentences around and get rid of these commas. There was a lot of editing that went on it that book. But it all came together. It was great. But then they, people asked us if you were going to do another one and I said, “Well, not me.” Somebody else maybe, but I’m okay with doing one.

WCI: Yeah. Obviously, I was only peripherally involved, but it looked like a lot of work. I did not envy you doing that, for sure. Speaking of factor investing you alluded to when you were talking about The Power of Passive Investing, let’s have your thoughts on factor investing. Which factors do you think are real and should be invested in? And which of these 500 identified factors out there are just bogus?

Rick Ferri: Well, you’re way behind the curve. There’s much more than 500. Anyway, okay. So factor investing, a couple of comments. Most people shouldn’t do it. You don’t need it. Certainly, it isn’t necessary to have in your portfolio, to have small-cap value, momentum, quality, these things that I call the flavor of the icing on the cake. You’ve got the cake, which is your stock and bond mix. You’ve got the icing on the cake, which is a portion goes into international stocks, a portion in US stocks. Then you have the flavor of the icing with the little sprinkles and flowers and everything on top and all of that, that’s factor investing. It dresses up the portfolio a little bit, with the hope of getting a higher return but always paying higher fees. That’s one of the big problems of it.

Rick Ferri: Theoretically, if you take the market and you divide it up into various buckets, there are some of the buckets have more risk than other buckets. Because those buckets have more risk, they should give you a higher rate of return. You can quantitatively divide the market up, like you said, 500 different ways to come up with these various buckets. But the buckets that have more risk are expected to give you a higher rate of return because there’s more risk. If you want to magnify that bucket in your portfolio, call it small-cap value, which is a very small part of the stock market. But if you want to magnify that bucket, magnify that risk in your portfolio, then you should get a higher return because you’re taking more risk.

Rick Ferri: However, you’re also paying more because factor funds are not dirt cheap like a total factor index fund. There’s one thing for certain, is you’re always going to pay more money in fees to get factor exposure. There’s been such competition out there, by the way, that a lot of the fees have come down. There are some factor funds out there that are very inexpensive now. So if you’re going to do it, you certainly want to go that direction. All right, so that’s number one. They’re more expensive.

Rick Ferri: Number two, you have to wait a long time. I have this saying, “If you’ve got the time, factors may be the place.” Because you might have to wait 15, 20 years before you get a premium return from these factors. They can go into a drought for a very long period of time. If you’re not willing to hold onto these things for a lifetime, like make it a lifelong commitment to be small-value factor invested so that you always have that small-value exposure, because you never know when it’s going to start to outperform. If you’re not willing to hold onto it for 20 or 25 years, literally a lifetime of investing, then don't do it to begin with.

Rick Ferri: Because what's going to happen is when it's not working and it's underperformed the market is when you're going to get tired of it, and you're going to throw it out, and you're going to go onto something else. That is probably the time where it's about ready to turn around. By the way, the thing you go into is probably the thing that's hot, so that's probably getting ready to turn around also. You end up with this lower rate of return consistently than the stock market. You have to really understand what you're getting. You have to pay low fees. You do it in an ETF if it's a taxable account because of the tax benefits of an ETF versus an open-end mutual fund. You've got to stick with it for the very long-term or don't do it. That's how I feel about factor investing.

WCI: How about real estate investing? What do you think about investing in real estate outside of publicly traded REITs, such as through individual properties or syndications of apartment complexes or private real estate funds?

Rick Ferri: Well, I don't really like private real estate funds and I've never invested in them, but they're very illiquid. If you need to get your money out of it, it's very hard to get your money out of a private real estate fund. I would personally avoid that. You would really have to know who's running it personally. That's not something I would do or recommend, unless you really, really know the people in the real estate industry, and really know the people who are doing this fund, and really know what they're getting into, and you can tie your money up for a long period of time. Fine. You could probably get a better rate of return than let's say if you did REITs, perhaps. I don't know that for a fact. But leave it at that.

Rick Ferri: To actually do real estate yourself, that's fine too if you want to deal with it. I mean you've got to buy the properties, maintain the properties, collect the rents, and all of that. I think that that's a good business to be in. I mean it's not passive by any stretch of the imagination. I mean you have to actively do it. That's not easy for a lot of people. What was the other one that you talked about?

WCI: I think you covered the question. Next question is about international stocks. Do you agree with Jack Bogle that an investor doesn't need international stocks in their portfolio?

Rick Ferri: Yes, because you used the word need. Okay? No, investors don't need international stocks in their portfolio. They probably need stocks in their portfolio, equity exposure, but they don't need international. Again, international stocks are the icing on the cake. It's not the cake. It might add something to the portfolio, or it might not add something to the portfolio. It does give you a little more diversification.

Rick Ferri: It does give you a hedge against a downturn in the US dollar, because international stock index funds are not hedged against the dollar, most of them are not. So you do have a little bit of a dollar hedge there. But it's not needed. It can help in the long-term. Of my own portfolio, 30% of my equity is in international and 70% is in US. If I didn't have any international stocks would I be worried about it? No. Not one bit.

WCI: You essentially wrote the book on ETFs. I mean it's literally called The ETF Book. Many beginning investors wonder if they should invest in ETFs or traditional mutual funds. What would you tell them?

Rick Ferri: Well, first off, it depends on whether you have access to ETFs. A lot of 401K plans are just mutual funds so you don't have access. The second thing is, where is your money being custodied? If you are, say you're holding your money at Charles Schwab and you want to buy a Vanguard fund, the commission to buy a Vanguard mutual fund through Charles

Schwab can be quite high. But you can buy the ETF for a much, much lower commission. It’s the same fund. In other words, at Vanguard the mutual fund and the ETF are actually the same pot of money. It’s the same fund, just a different share class. That is another reason you might want to buy ETFs as opposed to funds.

Rick Ferri: If you are in a taxable account, you probably want to stick with ETFs because they’re more tax efficient than mutual funds. The reason for that is because of this creation of redemption. You can buy my book. The ETF Book tells you all about it. But anyway, the bottom line is that they’re actually much more tax efficient. An established ETF doesn’t spin off capital gains every year, whereas a mutual fund would. If you’re buying something in a taxable account, a lot of times the ETFs, especially on the equity side, the ETFs are the way to do it. There are operational reasons why and tax reasons why you might want to use the structure of an ETF as opposed to the structure of a mutual fund.

WCI: Do you find that’s the case, the tax efficiency aspect is the case even with the Vanguard share classes? Are you slightly more tax efficient by using the ETF versus the traditional fund? Or are you able to flesh out those appreciated shares from the traditional fund via the ETF creation/redemption?
Rick Ferri: Yeah. That was a lot of words that you just said and the bottom line is that with Vanguard and Vanguard only, no other mutual fund company, just Vanguard, the tax efficiency of their mutual funds is the same as the tax efficiency of their ETFs because they are all the same pot of money. There’s actually, for the portfolio manager of the Vanguard funds/ETF, it’s sort of they can double tax manage the portfolio. If they have losses in the portfolio and they get redemptions on the mutual fund side, they can sell the stocks when they’re at a loss and so the fund itself starts to carry this tax loss carry forward. If they have gains in the

fund from stocks, then when they get redemptions on the ETF side they can push out the high cost basis stocks.

Rick Ferri: Again, a little complicated what I just went over, but the bottom line is it’s a very tax efficient structure at Vanguard. Vanguard and only Vanguard alone, whether you buy the ETF or the mutual fund you get the same tax efficiency.

WCI: Let’s turn now to talking about the advisory services. Lately, you’ve been pretty active on Twitter disparaging the AUM model of paying an advisor, paying a percentage of the assets under management. Tell us why you think that’s a bad model.

Rick Ferri: Well, I don’t think it’s a bad model so I want to clarify what I’m saying there. I did AUM for 20 years when I had my company but it was a low fee. The fee was appropriate for what we did. We talked with clients about what their asset allocation should be, what their tax situation was. I created portfolios of index funds, put them at Vanguard, then TD, then Fidelity, wherever they needed to be, and then we managed them. We managed them for a very low fee. Originally the fee was .25. I think that’s an appropriate AUM fee for, say, a million dollar account, .25%. If it’s a five million dollar account it should be less, maybe .2. If it’s a 10 million dollar account, it might be .15. Because as the account gets larger, the work that the manager has to do isn’t any greater. Now you might have a slightly higher liability, a slightly higher insurance cost, but the manager should be paid for the work that they do.

Rick Ferri: What I don’t like about AUM is what I call a wrap, if you will. You have people who are not only doing money management, they’re also doing financial planning, so full comprehensive financial planning. What they’re doing if they’re saying, “Pay me one percent a year.” Not .25, one percent per year on say, a two million dollar portfolio. Well, call it a one million dollar portfolio. Let’s be fair. Because that’s the average fee for a one million portfolio, one percent. “One percent and I will do a comprehensive financial plan and manage your money.”

Rick Ferri: Now, how much does a comprehensive financial plan actually cost? How many times do you do it? Well, it’s comprehensive so you only do it once. You don’t have to do it every single year. How much does it cost to actually do one? Well, the data out there through Michael Kitces is probably the ax on this. He’s done a lot of research. It costs about $3,500 in time for a financial planner to do a financial plan, 3,500. That’s if they charge $250 an hour and it takes them 15 hours to do a comprehensive plan, which is the numbers. That’s what they work out to be.

Rick Ferri: How much does it cost to manage an investment portfolio? Well, I know because I did it. I made a good profit on it. About .25 percent per year. You get .25 on a million, that’s 2,500. 3,500 the first year to do a comprehensive financial plan. Okay, I add that together and now I know I went through public schools but to me that came out to $6,000. But they’re charging $10,000. Well, what’s the other $4,000 for? I don’t know. But that’s just the first year.

Rick Ferri: The second year you don’t need another comprehensive financial plan. You still got the million dollar portfolio, it maybe went up a little bit. There’s going to be maybe some tailoring of the financial plan, call it $1,000. So you got $2,500 fee for managing the portfolio, maybe $1,000 for keeping the financial plan up, and that’s being very liberal. So that’s $3,500. Well, what’s the other $6,500 for? I don’t know. Why are you tying these services that are one-off services, that you only do one time, and maybe kind of keep it up a little bit over time, why do you keep charging the client year after year after year for the same service but you’re not delivering anything?

Rick Ferri: This is where my issue comes in. I don’t mind the

AUM fee for managing the investment portfolio. I don't even mind if some advisor says, "I'm going to charge you .4% or so," not .25 but .4, whatever it is for managing the investment portfolio. What I don't like is when they tie all these other services into the value of a portfolio which has nothing to do with the value of a portfolio, and a lot of them are only done one time. Yet they keep charging you year after year after year. That's my issue.

WCI: I mean bottom line, we all know why they do it, right? I mean I think I had an advisor tell me that AUM fees are the best kind of passive income there is.

Rick Ferri: For an advisor, absolutely.

WCI: For an advisor, absolutely. I mean that portfolio gets to be five million dollars and they're paying $50,000 a year for a service that perhaps you can get for five. That's pretty darn good passive income.

Rick Ferri: It makes the value of your company go way up.

WCI: Yeah, it does. So is it possible, I've explored this with a few advisors, mostly people starting out and kind of just thinking about it. Is it possible to start the Vanguard of financial advisory firms? Can this be done successfully via a mutual model?

Rick Ferri: Well, I think this is what Betterment is trying to do, and Wealthfront is trying to do, is they're trying to establish themselves as the Vanguard of the advisor world by automating everything, making it online. With Betterment now you could call up and get as-needed advice kind of a la carte that you just pay for. Or you can hire them for $100,000 you can hire them for .4%. So $400 a year they'll manage the $100,000 portfolio and give you financial advice on your other $10 million. You could have $10 million outside of Betterment, $100,000 with Betterment, pay them .4% on the 100,000 and they manage the 100,000 but now you have full access full-time to five financial planners at Betterment who will help you with everything you have.

Rick Ferri: I mean that's democratization of financial planning and democratization of this whole program. That's where Betterment has gone. Now Schwab has kind of followed suit with their $30 a month offer and their Intelligent Portfolio dollars upfront and then $30 a month after that. Correct me if I'm wrong on that. They're kind of competing against the Betterment model. This is the way in which advice is going.
WCI: Do you think you can really get good advice for $30 a month?

Rick Ferri: Yeah, I think that 90% of the advice people need is standardized. I mean let's just kind of back up for a minute. I mean the tax code is the tax code. If you go to one CPA and you say, "Do my taxes," they're going to come out with a solution and they might charge you $1,000. If you go to another CPA and you say, "Do my taxes," they're going to come out with pretty darn close to the same solution but they want to charge me $10,000. Well, why would I want to pay you 10 when this firm over here it's one, and it's really all the same tax code, and you guys came to pretty much the same solution? I think that that's the way it is with most financial advice.

Rick Ferri: I mean should you do a Roth conversion? I don't know. Let's talk about it and let's look at the taxes and I'll give you the options. I mean the rules for doing a Roth conversion are the same for everybody. The financial planning rules out there are the same for everybody. So 90% of the financial planning advice people get is pretty generic. I know because I talk with clients every day. It's pretty generic. It's pretty straightforward. So why would you pay five, 10 times the money? The advisors try to say they add value. They're giving the client a better experience. I don't see how.

WCI: Now, Bill Bernstein says less than one percent of investors can be successful as do-it-yourselfers. Do you agree with that or disagree?

Rick Ferri: I don't know if I agree with Bill or not. What does he mean by success? Can you quantify it?
WCI: I think he's saying they'd be better off hiring an advisor than managing their own investments.

Rick Ferri: I think that the world is changing. Where that might have been true several years ago, I think the internet is helping people become better educated. In fact, Morningstar just did a study that showed that people who are managing their own portfolios using the internet have gotten a lot better at it and are almost up to the standards now of if you were to hire a professional advisor. In fact, I think that Jason Zweig just wrote something in the Wall Street Journal which basically said the same thing, that individual investors are getting a lot better. So I don't think that one percent stands anymore.

WCI: Now, you and Larry Swedroe had a few well-known debates and disagreements on the Bogleheads forum over the years. Which one do you think was the most significant and interesting to engage in?

Rick Ferri: Well of course, in every debate I was correct and Larry was wrong. Let's see. Let's see if I can think of it. No, I think we talked about commodities 10 years ago, where he was all hot to trot on buying commodities. I used to have my commodities license if you go back 20-something years ago, so I really understood commodities pretty well and futures. I said, "No. This is not what you think it is. This is not the panacea to end portfolio volatility. You're not seeing this thing for what it is." Well it turns out that, that was 10 years ago. Turns out that commodities have done terrible. In fact, I was just reading that Larry actually sold his commodity funds. So there you go.

WCI: Yeah, how about that? You certainly won that one. Here's another question for you that I've noticed among people I call intermediate investors. They start engaging in this search for the perfect portfolio. What advice do you have for that person?

Rick Ferri: There is no such thing as the perfect portfolio. There is the best portfolio for you given your situation, but you can never find the perfect portfolio. You can never find the optimal asset allocation. All you're going to do is drive yourself crazy. You're going to keep on adding things, taking things out, trying to find the ideal mix, trying to find negatively correlated asset classes. You're going to go down a lot of rabbit holes. The bottom line is what works is a simple portfolio, something like the three-fund portfolio. That works. All this other stuff, way too complicated.

Rick Ferri: You have this epiphany about indexing where, "Oh, I should buy index funds because active managers don't do well," which is great. But then the next level of that is complexity. Complexity is doing what you're saying, trying to find the ideal, perfect portfolio, the ideal asset allocation, optimal … using Monte Carlo simulation models on and on and on to try to find what's going to work in the future. You just can't do it. The last level of investor enlightenment is simplicity, which is realizing that that stuff isn't working and getting to the simple portfolio that you really need for the long-term.

WCI: All right. Now, I asked yesterday, told people we were going to have you on the podcast today and asked them on Twitter to see if they had any questions they wanted me to ask you. We had a few come in, so I'm going to fire you a few of these. One comes in from Kevin, who says, "Do you foresee a significant increase in advisors using flat-fee and/or hourly billing?" He feels like the AUM model has been a windfall for advisors over the last decade. There are now lots of independent advisors, and that maybe it seems too lucrative for them to give up that model.

Rick Ferri: Yeah, they’re going to come in kicking and screaming. Remember what happened when Jack Bogle introduced the first index fund. It was called Bogle’s folly. In fact, one of the fund companies called it un-American. The fund company was making too much money. They wanted to crush this idea of indexing right at the beginning. It took many years, I mean it literally took 25 years before indexing actually caught on. That was 1976 when the first index fund was launched. I think it took 12 years to get the first billion dollars into index funds.

Rick Ferri: Now, I don’t know how many trillions of dollars are in index funds. But the bottom line is it’s an exponential curve. I’ll give you another example. The commissions, there used to be fixed commissions rates at brokerage firms. All brokerage firms charged some ungodly fee like two dollars per share to trade stock. Then they had eighth, eighth of a point up and down. I mean brokerage firms were making an incredible amount of money on commissions until they did away with fixed commission rates. Then Charles Schwab comes out with discount brokerage. Now you can trade stocks, trade in ETFs for almost zero. I mean fractions of a penny.

Rick Ferri: What about advisor fees? It’s the last bastion of gluttony in the investment industry, is advisor fees. I mean mutual fund fees have come way down to almost nothing. Indexing has driven even active fund fees down, and indexing fees are almost at nothing. Trading costs are almost at nothing. Where the fat is now in this industry is in advisor fees, and it’s being targeted. So advisors can hold on to what they have for only so long. As the world begins to become more educated and investors become more educated through the internet, I think advisors are going to be forced to look at other models.

Rick Ferri: Either discounting their fees if it’s AUM, or doing some sort of an AUM with a cap maximum fee, or doing flat fee, but something is changing. Every day I get emails from people who are asking me, getting into the business, what do I think about their fee model and so forth. The ones who are doing one percent or high AUM right now are going to give it up kicking and screaming, but eventually, the world is going to slowly push them out like they've pushed out two dollar commission rates per share and like the world has pushed out one and a half percent mutual fund fees. Although, there are still some out there.

WCI: I wonder how many of them feel like they're in a race to their own retirement. See if their plans give up on them before they can get to retirement themselves. I wonder.

Rick Ferri: I don't know, but there's a lot of people who are looking for those clients and it's not a hard sell. I mean with interest rates down at two and a half percent on a 10 year treasury, expected return from stocks going forward, I put it at maybe six, six and a half percent. A balanced portfolio 50/50 might give you four and a half percent or so. A one percent AUM fee really digs into that. Then you have two percent inflation on top of that. Then you have taxes on top of that. Net-net it's a zero percent return to the client. If the client can squeeze out an extra .6% or .7% by switching advisors, they're going to do it.

WCI: Yep. So Richard on Twitter want to know if you'd entertain the idea of a bi-monthly Bogleheads Podcast. For those of my listeners who don't know, Rick does the Bogleheads Podcast. I think it's been a monthly, usually with a guest, show since you began it. You want to tell us a little bit about that?

Rick Ferri: Yeah. It's a non-profit organization, the John C. Bogle Center for Financial Literacy, which pays the $100 per year for me to do podcast hosting somewhere. Anyway, so we say that it's funded by the John C. Bogle Center for Financial

Literacy. But pretty much I spend a day interviewing a special guest. I had John Bogle on as my first guest. That was a really great interview. Then I had David Blitzer, who is now the retiring chairman of the S&P Index Committee and that was fascinating. I've had a lot of other guests, Gus Sauter and Christine Bense and so forth. I'm going to have you on someday, Jim.

WCI: That'll be fun.

Rick Ferri: You're on my list. I just talk with them for an hour and ask questions and we get some really good insight. But I'm only doing it once a month. I think that once a month works for me and my schedule. I think if I did it more than that it'd be just too taxing on me. I wouldn't be able to keep it up because I've got so many other things going on. I'm writing another book. I'm doing my own business now. I have a family. Yeah, once a month works for me.

WCI: All right. So somebody that calls themself a retiring fed asks you if you're concerned about that Vanguard executives will enrich themselves at the expense of Vanguard's owners now that Jack Bogle is gone.

Rick Ferri: Well, Jack Bogle has had no say in what Vanguard does since 1996. He was the face, if you will, for many people but he had no say. I don't think that Jack Bogle passing has anything to do with whether Vanguard executives are going to enrich themselves. One thing that was interesting in Jack Bogle's last book that he wrote called Stay the Course, was that Vanguard executives get paid bonuses at the end of the year and I didn't realize that. The bonuses were based on sort of quasi profitability, meaning how much money did Vanguard save shareholders. If you think about it, the people that are working at Vanguard, with their experience level they could go anywhere and make, you would think make a lot more money.

Rick Ferri: But the answer is not really because Vanguard makes sure that the executives and the people that are working at Vanguard are well compensated at industry standards for the positions that they hold. If you look at what the people are making at Fidelity, people are making PIMCO, American Funds, or whatever, and you sort of take the big industry average for each position, the Vanguard people are making close to that. If they weren't, they wouldn't stay there, but they are. That's why they can keep their employees. I don't think that's enriching them, but they are getting compensated at industry standards even though Vanguard is a low fee sort of mutual benefit company. I don't have any problem with that, by the way. My fees are low enough at Vanguard. I'm good. If they're paying their people who are doing that for me industry standard wages and bonuses I'm fine with that.

WCI: Now, Mike on Twitter wants to know what your asset allocation is by percentage.

Rick Ferri: My money is coming in from the sale of my business as I talked about. I had most of my wealth in the business, with the exception of a retirement account and so my cash is coming in now. At the moment, my account is still fairly heavy in cash because I had to pay taxes, number one. Number two, I just haven't gotten it invested yet. But when it is invested I'm going to be 80% equity and 20% fixed income.

Rick Ferri: The reason for that is when I look at my social security that I'm going to be getting at age 70, my wife's social security. I have a military pension because I'm retired military. I have some small pensions coming in from Kidder Peabody, which was a GE company. Then Citigroup, which is Smith Barney owned, Citigroup owns Smith Barney. I have all this income that will be coming in from these other sources and my needs are modest. I mean my expenses are less than $5,000 a month. So I look at that and I say, "I have all this income coming in." The money that I am getting in now from the company that will be invested is just going to be in almost all equity.

Rick Ferri: I’ll also say something else, and I very rarely say this, so this is a scoop on your podcast. The fixed income portion of my portfolio, only a small portion of it, basically two years worth of living expenses are in a short-term bond index fund. The other portion of my fixed income is in a preferred stock index fund. I’ll give you the symbol. P as in papa, F as in Foxtrot, F as in foxtrot, D as in delta, PFFD. The reason for that is because this is taxable money and preferred stocks pay a dividend, which is actually a tax efficient dividend, and it’s at a relatively high rate relative to corporate bonds. I can get into the whole structure, but it’s really a unique asset class. I may have talked about it in one of my books about preferred stocks years ago.

Rick Ferri: I used to manage individual portfolios of preferred stocks for clients. They did very well so I really understand the preferred stock market. So a pretty good portion of the fixed income portion of my portfolio is in a preferred stock index fund. The rest of it is in VTI and the Vanguard Total International fund. I forgot the actual name of it. That’s it. I am thinking about putting some money in a very deep factor fund through Alpha Architect, Wes Gray, who you probably know. Only because I think it would be kind of … I talked about my bingo money. I like Wes. I like his company. I’ve been there many times, to Alpha Architect. I might put some money, some wild, crazy money in one of their deep factor funds. But that’s about it.

WCI: You’re definitely practicing what you preach with simplicity there. That’s a pretty simple portfolio.
Rick Ferri: Probably not as simple though as what … I know the preferred stocks are a little complex and the factor fund is complex, but everything else is the same.

WCI: Now a lot of people want to hear about this RV trip of yours, particularly these people that are into the Financial Independence Retire Early movement. You took some time off to travel around the country in an RV. What was that like and could you do it long-term?

Rick Ferri: I did, when I was having my problems with my second lawsuit, with my second business partner. My wife and I sold everything, literally sold everything. Sold the house, sold all of our possessions for the most part, sold almost everything and went on the road for two years, living in a 20-foot pull trailer. That basically, you walked in, it was enough room for a king size bed, a little tiny kitchen area, a little tiny bathroom, and a little tiny eating area. We dragged that camper all over the country for two years. That's where we lived until last summer.

Rick Ferri: So what was that like? My wife really got tired of the little bathroom pretty quick. She said, "If we ever get another RV we're going to get a bigger bathroom." "Okay, okay, fine." It was interesting on how little you need to live. I guess now that we've done that and that we've moved back into a small house. We're actually living in an over 55 retirement community in a small single-family home, two bedroom and an office. Really like it a lot out here in Georgetown, Texas.

Rick Ferri: But we have real difficulty now buying kind of discretionary things. It's an interesting thing to do, to minimalize for a while and live this minimalistic lifestyle for a while. When you come out of it, you realize that you don't need much. You certainly don't need a lot of the stuff that you've accumulated over the years. You really look at life and you look at how you live your life, just a lot differently after doing that for a couple years. I think that's what I got out of it.

WCI: But clearly you wanted to move at the end, huh? You're not still doing it obviously, after a couple of years.
Rick Ferri: You know, we would have continued. We talked about it, whether we were going to continue or not. Again, I would have had to upgrade the RV, get a bigger bathroom.

WCI: Do they even make RVs with decent sized bathrooms? I've never seen one.

Rick Ferri: They do now. Yes, they do. In fact, you think about the RV market and what they're doing, they're looking at the demographics and they're listening to people. People are going into these RVs saying, "Oh, the bathroom's too small. Oh, the bathroom's too small. Bathroom too small." So now you can get RVs where it's actually got a decent sized bathroom in it. Anyway, because this is what people want, queen size beds and all the luxuries of life. It is an interesting lifestyle. If you really want to see the country, it's great … I still have the RV.

Rick Ferri: The one thing I'm going to do, I'm going to spend four months either next summer or the summer after that, I'm going to go from Texas all the way up to Alaska. I'm going to travel around in Alaska for about a month and a half. Then I'm going to come back to Texas using a different route. I'm going to go from the center of the country going up to Alaska, do Alaska, and then I'll come down the West Coast coming back to Texas. It's going to be about a four month trip. Probably 10,000 miles just to get up there and back, and then another four or five thousand miles when I'm up there perhaps. That's probably my last trip with this RV. At least the one that I have because the wheels will probably fall off.

Rick Ferri: But anyway, I want to do that. I have a longing every once in a while. I'm in the house right now and I'm in my office and it's nice, but I really have a longing every once in a while to get back out on the road. It's just, I don't know, it's sort of like bring you back to reality once in a while of what it is you really need. I enjoy it.

WCI: So our time's getting short but I wanted to explore something just a little bit more that you're doing now with your life. You've started a new firm since the RV trip ended. Can you tell us a little bit about that and how you're modeling it? What you’re doing and how you’re charging for it, et cetera?

Rick Ferri: Yeah, I’d be happy to. Thank you for asking. So I had a non-compete that was over with this month, actually. Just really started this company called Ferri Investment Solutions. I am charging people by the hour for investment review and investment recommendations. It could be as little as a half hour of time. People contact me, and I’ve had several wonderful conversations already and it’s only been a couple of weeks. This is the third week. About two people a day, I can schedule a session in the morning and a session in the afternoon.

Rick Ferri: People send me their information and I spend about an hour with them on the phone. Sometimes I write up something at the end. I charge a $500, what I call a portfolio second opinion. Then the people, who are generally do-it-yourself investors, will go out and take my recommendations perhaps and do it on their own. I have seen … I’ve done this, probably have 25 people so far and I’m thinking I’m just getting started. But I’ve seen the gamut of different types of portfolios. I’ve seen the most brilliantly well-managed portfolios you could ever imagine. I mean they would go in Portfolio Beautiful Magazine, no word of a lie. I mean absolutely everything done spectacularly on the tax efficient side, on the simplicity side, everything done extremely well.

Rick Ferri: And I have seen the worst portfolios. I mean just full of junk, terrible high cost stuff. They realize this, the clients who have those portfolios realize this and they want help to how to get it back to something that’s better. So I’ll spend time with them. Sometimes it takes more than an hour. I charge $450 an hour to work on spreadsheets and this and that to get them to a better portfolio using what they already have. But that’s all I’m doing. Generally, most of it is just a one-time help you out when you need it, send you on your way. If you need me again, just schedule another hour and talk with me again. That’s my whole business model. I really enjoy talking to the people. I really enjoy looking at all these different types of portfolios and what people have done, and helping them out when they need to be helped. So that’s my whole business model right now.

WCI: Well it’s beautiful because you can walk away at any time. Right? You’re not doing any of the management. You basically get to control your hours and work as much or as little as you want.

Rick Ferri: That’s correct. If I wanted to take a month off I just block out the whole month. Talking about people … Now I’ve had several people who have come to me and say, “I don’t want to do this myself. I want somebody else to do it.” Now here’s what the interesting part is. I won’t mention any names or mention any companies, but I will go to an IRA firm, a money management company. I will say to them, “I have a client who has five million dollars. This is what the portfolio is going to look like when it’s done because I’ve already redone everything. So the taxable account is going to look like this. The tax exempt account is going to look like that. Here’s the portfolio. It’s five million dollars. What fee are you going to charge my client?”

Rick Ferri: “Uh, uh, uh, uh, uh.” All right. So generally, our negotiating the fees for clients, it’s .25 percent and less. Without mentioning any names, yesterday I negotiated a fee for a $5.5 million client and it was a little under .2 percent. This is full portfolio management. So the advisor is going to take this portfolio, implement the changes that I worked on, is going to get the portfolio in shape, manage it on an ongoing basis, do rebalancing when it needs to be done, do tax management, send the client reports, be the administrative person for the client so if they needed money doing required minimum distribution and everything, but the whole full gamut.

Rick Ferri: But what happens is because I’m in the middle of it, the typical fee for that particular advisor may have been a half a percent. They're doing it at a little less than .2 because I went in there and I said, "We're not paying any more than that." I know how much money they're going to make on the account. They're going to make $10,000 a year. I know how much work that account is going to be, because I did it for 20 years. I know exactly how much time that manager has to put in. $10,000 is a pretty nice paycheck for doing that work. But-

WCI: What a wonderful service, thought. Right? Not only do you get somebody to help you design the plan, the portfolio, but you get somebody who knows what they're doing to negotiate the fees for you. I mean that's wonderful.

Rick Ferri: Yeah, so that's working out really well.

WCI: Yeah.

Rick Ferri: If an advisor says, "No, I can't do it for that," I say, "Okay, fine because I know five other advisors who will." That changes the conversation. They say, "Wait a moment. Let me get back to you. Let me talk to my business partners." The next thing you know, "Okay, we can do it."

WCI: Wonderful. That's wonderful, what you're doing. We'll put a link to that in the show notes as well. It's just RickFerri.com you can get that information on that from. But we're probably at the end of our time here. I've kept you longer than I promised you, I think. But this podcast is going to be listened to by 20 to 30,000 people, mostly high-income professionals like doctors. Do you have any advice for them that we haven't already covered?

Rick Ferri: I can only say from experience that the simpler you make things, the better. Use all your tax efficient accounts that you can use, cash balance accounts, whatever it is that your CPAs and advisors are telling you to set up to save on taxes every year. But make it as simple as you can, and then when you go to invest the money, that is really not that important. Just put it in something very simple, a three-fund portfolio, something that you don't have to mess with, and just keep on doing it over and over and over again. Simplicity, automation, hibernation.

WCI: Love that, hibernation.

Rick Ferri: Just make it simple. Make it simple, make it automated, and just let it do its thing. Don't touch it. That's the best advice I can give.
WCI: Thank you so much. Rick Ferri, CFA, we sure appreciate you coming on the White Coat Investor Podcast today.

Rick Ferri: Thank you for having me, Doctor.

WCI: All right. That was great having Rick on here. He's been a huge influence in my life financially, certainly has influenced my own portfolio. It's interesting to find his portfolio is so simple now as he kind of comes toward the end of his career, but that was wonderful. Certainly, I'm really supportive of what he's doing with his new service. It's not dissimilar from Harry Sit and some other people out there who are trying to guide people to the good guys in the financial advisory industry. Certainly something I've tried to do as well. Maybe not with as much success as I would like, but certainly something we'll continue to improve as we go along.

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