FROM THE FRONTLINES TO FINANCE

How the Marines Shaped Our Fiduciary Ethos

By Wesley R. Gray, PhD, and Patrick R. Cleary

Serving in the Marine Corps was an unforgettable experience that involved intense physical training and rigorous development of self-discipline and character. Citizens often tell us “thank you for your service.” The real thanks, however, is owed by us to the Corps for providing valuable life lessons. The not-so-subtle teachings bestowed by insanely aggressive Marine Corps drill sergeants are still, literally, ringing in our ears: “Listen here, pond scum, you better run faster, shoot straighter, and think quicker if you are going to win in battle!” We tested that training in real-time, battling insurgents in Iraq, and these lessons have proven essential off the battlefield as well.

Since we traded our flak jackets for laptops and neckties, we’ve found that the following four core lessons from the Corps apply to frontlines and finance alike:

1. Humans are emotional—systematic processes beat behavioral bias.
2. Rambo isn’t realistic—act on evidence, not on stories.
3. Complacency kills—focus on fundamentals and never stop learning.
4. Integrity is everything—do things right and do the right thing.

The first three lessons all revolve around preventing overconfidence, performing in stressful environments, and ensuring we add value for our clients. We, as asset managers, are flawed, but we can overcome our deficiencies via systematic processes, evidence-based decision making, and by continually learning and improving. Our fourth lesson—integrity—underpins everything. To us, integrity is doing things right and doing the right thing.

We are thankful that the lessons we learned in the military kept us alive and brought us home. Today, we continually discover that the “combat classroom” proves to be the best preparation for a deployment to Wall Street.

Background

We first met in 2001 as undergraduates at Wharton. In many ways, we were totally different: Wes was a 5’10,” 160-lb. pole-vaulting quant-geek; Patrick was a towering 6’4,” 200-lb. rugby player and fraternity president. We had one thing in common—we both wanted to be Marines. In the context of an Ivy League university, it’s very rare to find other individuals with a desire to join the service. We became immediate friends. Wes, a few years older than Patrick, was the first to sign up for the Corps. However, fortune had other plans for Wes: a full-ride scholarship and stipend to the University of Chicago’s PhD program in finance. With a heavy heart, Wes decided against the Marines and headed to Chicago.

Meanwhile, Patrick survived boot camp, graduated from Wharton, and began training as a Marine officer. He relayed to Wes detailed stories of the training, personalities, and culture that made the Marine Corps unique. As Wes slogged through his PhD studies, the pull of military service grew stronger. Wes formulated a plan and set up a meeting with his PhD advisor; his message was that it was time to join the Corps. “Are you serious?” the advisor responded. “You realize there is a war going on right now, right?” Once they got over the shock, Wes’s advisors became supportive. For the first time in the program’s history, a finance PhD candidate was granted four years of sabbatical to serve in combat.

We each served four years, 2004–2008. Patrick specialized in combat engineering and Wes served as a ground intelligence officer. Each deployed to Iraq and learned a great deal about leadership, trust, humility, and a deep sense of what it means to be a true “fiduciary”—not in the sense of being a protector of another’s assets but in terms of safeguarding the well-being of our fellow Marines.

When Wes’s contract expired, he returned to Chicago to finish his dissertation, then landed an academic post at Drexel University in Philadelphia, his wife’s hometown. He also founded an asset management firm, Alpha Architect. Patrick left the Corps and entered an MBA program at Harvard. He ended up at the Boston Consulting Group as a management consultant in Philadelphia, his wife’s hometown. Five years later, after a lot of arm-twisting, Wes convinced Patrick to join Alpha as chief operating officer. A nine-person team now manages an emerging asset management firm dedicated to empowering investors through education. We have nearly $225 million in assets under management and seek to deliver high-conviction, tax-efficient strategies with affordable costs.

Our Marine Corps experience continues to shape our outlook. Consider the following:

Humans are emotional: Losing money is an emotional event; getting shot at is even
more emotional. A systematic approach for handling chaotic environments is critical to success, for the advisor and the client.

**Rambo isn't realistic**: Pumping iron and strapping on hundreds of rounds might work in the movies, but in real life the methodical, evidence-based approaches to warfare are much more effective. Guiding individuals through the evidence, although more intensive, will ensure they understand the mission and how to achieve success.

**Complacency kills**: Success is often the surest way to predict defeat. Victory leads to overconfidence, overconfidence leads to laziness, and laziness can lead to death. Shower your clients in value-add education to empower them as investors. Keep them sharp and maintain a learning relationship.

**Integrity is everything**: If you can't trust the individuals to your left and your right, you cannot accomplish the mission. Honest communication and full transparency are paramount to any endeavor. Fiduciaries can charge fees only for value-add activities, and those fees must make sense. Specifically, simply charging what the market deems appropriate is insufficient. One must question the services provided and their inherent value.

**Humans Are Emotional—Systematic Processes Beat Behavioral Bias**

While stationed in Iraq, we saw stunning displays of poor decision-making. Obviously, in areas where violence could break out at any moment, it was of paramount importance to stay focused on by-the-book standard operating procedures. Why? In extreme conditions, where temperatures regularly reach more than 125 degrees, stressed and sleep-deprived humans can sometimes do irrational things.

For example, carrying 80 pounds of gear in the frying desert sun makes you hot. But many things that are necessary for survival in a combat environment, such as extra water, ammunition, and protective gear, are heavy. A completely rational thinker weighs the cost of carrying gear (sweating profusely, discomfort, etc.) against the benefits (not dying). A more emotionally driven decision-maker disregards the cost/benefit analysis and goes with instinct—toss all the gear, get some fresh air, and hope for the best. Figure 1 shows examples of a rational approach to combat and an irrational approach to combat.

Figure 1 shows Wes, on the left, at a combat checkpoint in Haditha, a village in Al Anbar Province. He is explaining to his Iraqi counterparts how to set up a tactical checkpoint. A quick inspection of the photograph highlights how a stressful environment can make some people do irrational things. Wes and the Iraqi soldier in the center are wearing Kevlar helmets, carrying extra ammunition, and have a water source. The Kevlar is important because mortar rounds may be inbound. Rational reaction: Wear Kevlar to prevent hot metal fragments from entering one's head! Ammunition is important because one needs ammunition in a gunfight when terrorists are slinging hundreds of 7.62mm rounds in one's direction. Rational reaction: Carry ammo! Finally, water is important, because in 125-degree weather a lack of hydration can lead to heat stroke. Rational reaction: Carry water! But the Iraqi soldier on the right isn't wearing a Kevlar helmet, isn't carrying extra ammo, and doesn't have a source of water. He has ignored his training, has succumbed to an emotional shortcut, and is acting irrationally.

Is Wes's irrational Iraqi friend abnormal? Not really. All human beings suffer from behavioral bias and these biases are magnified in stressful situations. After all, we're only human.

The conditions we describe in Iraq are analogous to conditions investors find in the markets. This may sound like a stretch, but it is not. Watching our hard-earned wealth fluctuate in value is stressful. Stressful situations in markets, as in physically dangerous environments, breed bad decision-making. To avoid the potential for bad decisions in stressful environments, we need to deploy systematic decision-making and train our clients to think in a systematic way, much as we did as Marines. To be the best fiduciary for your clients, empower them to follow a process and stick to a plan, both of which are critical to their success.
Rambo Isn’t Realistic—Act on Evidence, Not on Stories

For many civilians, their only “experience” of war is from video games and Hollywood movies. A classic example is the Rambo movies. Rambo is a 1980s action movie series starring Sylvester Stallone as a deranged Vietnam Special Forces veteran hell-bent on blowing up things and killing anyone who gets in his way. Rambo has a remarkable ability to kill waves of foreign soldiers furiously shooting in any direction. For example, in *Rambo III*, Rambo kills 132 enemies and is involved in 38 episodes where he manages to avoid getting killed by enemy gunfire (Mueller 2008).

Rambo’s combat experience is not realistic, yet in the movies his story is appealing. Intellectually, we know Rambo is a story and Rambo’s actions are not based on evidence. And yet, everyone wants to believe, on an emotional level, that this heavily muscled superstar warrior is invincible. We see this same element of “hero worship” in financial markets. Investors want to believe equally unbelievable stories—for example, that certain managers have magical powers to beat the market every year for eternity. As with Rambo, it’s appealing. But why do we believe in these stories?

The foundation for our persistent belief in stories, in spite of ample evidence suggesting a story literally should not be believed, has perplexed researchers for many years. In one classic academic study, the behavioral psychologist B. F. Skinner and several colleagues demonstrated that our innate need for superstition is deeply ingrained in our primal brains (Skinner 1948). To make the point, Skinner studied one of the more powerful brains in the animal kingdom—the pigeon—and found that pigeons associated the delivery of food with random actions they had been performing even when the food was simply being delivered at regular intervals. In other words, the pigeons were “superstitious” or suffered from “story bias.”

But pigeons aren’t the only animals that experience story bias. We worked alongside many Iraqi soldiers and fellow Marines who wanted to believe they were Rambo (see figure 2). Many of the Iraqi soldiers felt it was imperative to strap ammunition rounds across their chests and then rapidly shoot from the hip when engaged in combat. This Rambo-esque approach to a gunfight is absurd, inefficient, and dangerous. The rounds across a fighter’s chest are exposed to the elements and the operator can never properly load them into the weapon system when they are needed most. Plus, shooting blindly from the hip is a great way to waste ammunition because it rarely hits the target. Being Rambo sounds cool in theory but doesn’t work in practice. Well-trained Marines take a different, more evidence-based approach. Marines ensure all ammunition is loaded into clean-functioning magazines that are stored properly on their persons. They spend countless hours loading and unloading magazines into their rifles to ensure the process is seamless in a combat environment. Finally, Marines take well-aimed shots at their enemies, focusing on the principles of marksmanship, even when they are amped up and in the middle of a firefight. A single effective round is worth 30 poorly aimed shots.

Do we see Rambo activity in financial markets, where people believe a story but disregard evidence? All the time. Take Wes's uncle as an example. He is convinced that a Dallas Cowboys victory during the Thanksgiving Day football game is a great signal for the stock market. The logic is as follows: The Cowboys are “America’s Team,” and if America’s Team is doing well, people are happier and they spend more money.

Of course, the Dallas Cowboys indicator is completely bogus. Yet clients readily buy into other, subtler investment stories: High fees equal high performance, my guy is associated with a top Wall Street firm and can give me an edge, buy into funds with top short-term performance, etc.

The point is that clients often place too much faith in Rambos of the market. They believe in a story without looking at the facts. So as fiduciaries, we must do more than simply select an appropriate basket of products. We must always go the extra mile to educate and empower our investors to withstand the appeal of placing faith in Rambos and start relying on evidence-based strategies that provide the best shot at compound wealth on an after-fee, after-tax basis.
Complacency Kills—Never Stop Learning

During Operation Iraqi Freedom, the message was everywhere. In the chow hall, on blast walls, in supply bays, and at checkpoints, “COMPLACENCY KILLS” was spray-painted everywhere in bold, black, stenciled letters. Figure 3 shows a picture that Wes took in Barwana, before heading out on a combat patrol. The reminder was seen by all Marines before they stepped “outside the wire.” The gaping hole from an inbound artillery shell strongly complemented the message.

Not surprisingly, complacency also kills in the financial world. When meeting with investors or family offices, we often see signs of complacency and a disregard for investing fundamentals. For example, investors sometimes do not focus on fees, spend too much money on their investment advisors, or end up buried in expensive bank products they don’t understand.

Investors also lose sight of the importance of taxes. Failing to stay vigilant about the effects of portfolio turnover or the choice of investment vehicles can destroy returns. What is the real value of alpha for a taxable investor in a fund that earns a 10-percent return but only 5 percent after taxes? Perhaps a more tax-efficient fund, with lower turnover, makes the most sense? Amazingly, few individuals we speak with are fully aware of tax-efficient alternatives such as exchange-traded funds (ETFs).

Another area where we see investor complacency is in allocations. Over time, allocations can get out of sync, as investors fail to maintain target allocations or struggle to stay vigilant about portfolio rebalancing requirements. Investors can become overly concentrated in positions or asset classes (such as being over-allocated to cash). In low-volatility environments, investors can be lured by the siren song of leverage. Nevertheless, as investors, it is important that we make consistently good decisions in order to make a return on our capital while avoiding unnecessary risks.

As fiduciaries, we must constantly drag our clients back to the basics. In the Marine Corps, the fundamentals are simple: Shoot, move, communicate. In investing, the fundamentals are simple, too: Maximize after-tax, after-fee, risk-adjusted returns. But just because something is simple doesn’t necessarily mean it is easy. As fiduciaries, we need to religiously focus on continuous improvement and always remember that complacency kills.

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Integrity Is Everything—Do Things Right and Do the Right Thing

Of the 14 Marine Corps leadership traits, integrity is the most important. The official definition is the following: “Uprightness of character and soundness of moral principles. The quality of truthfulness and honesty.”2 To both of us, having integrity means doing things right and doing the right thing.

Integrity can benefit clients, but it can also literally save lives, as Patrick knows first-hand.

An important part of Patrick’s mission in Fallujah was to build fortified positions along key pieces of terrain. Such positions prevented insurgents from planting improvised explosive devices (IEDs), but it also brought risk. Every additional Marine exposed was an incremental enemy target. Such missions require brutal honesty with yourself in terms of risk (potential Marines lost) versus reward (IED attacks thwarted).

In one instance, an officer requested that an oversight position be built atop a highway overpass. The position provided great visibility, but a suicide car bomb could literally drive beneath the post. It simply didn’t make sense to expose Marines to that amount of risk, based on evidence from prior attacks. Patrick was convinced the post was nothing more than a giant bull’s-eye.

Patrick explained to the officer why the post was not a sound idea, and the discussion quickly escalated into a diatribe as to why Patrick, as a junior lieutenant, should go ahead and build the post. Patrick stood his ground, took the verbal beating, and built a post that provided slightly less oversight but a lot more protection. He worried he would be relieved of command for disobeying a direct order.

Relief never came, but the insurgents did. The day after the post was completed, insurgents drove a dump truck laden with explosives as close to the post as possible. The overpass, which could have been home for six Marines that day, was completely destroyed. The combat post survived the explosion.

Arriving onsite, Patrick quickly surveyed the damage. “Corpsman!” he called, which is Marine-speak for “medic.” “Any casualties?” Patrick was filled with dread, but he had to know. It was his unit’s work and ultimately his call. His Marines responded: “We’re good sir. No KIAs. Boys definitely got their bells rung, but they’ll be all right.”

It wasn’t easy for Patrick to stick to the plan, but his Marines are glad he did. Doing things right and doing the right thing literally saved their lives. In the context of finance, integrity doesn’t necessarily determine the difference between life and death, but it is critical nonetheless. Warren Buffett has said that integrity is everything: “In looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if they don’t have the first, the other two will kill you.”3 Sadly, the financial services industry has had its fair share of dishonest practices and less than sterling examples of integrity. Do clients really need proprietary products with extremely high fees? Can we honestly justify a 2-percent advisory fee for a client that invests in a
portfolio of passive ETFs that never changes? Do we, as fiduciaries, honestly think soft-dollar arrangements or 12b-1 fees are ethical? And even if you do believe in the value of these services, are the expenses to the client worth it? Would you tolerate these fees and practices for your own nest egg?

These are tough but necessary questions. A true fiduciary must dive headfirst into an industry that is plagued by the disconnect between fee generation and value-add services. Just because a practice is common and/or legal doesn’t mean it is the right thing to do. Again, integrity is about doing the right thing, not about doing what everyone else is doing.

Conclusion
Successful counterinsurgency campaigns are measured in decades. The foundation for a lasting peace requires years of listening, respecting, building, and empowering a local population to achieve its vision of a society. There are no shortcuts or easy answers. For Iraq, the mantra of the Marine Corps was clear: “No better friend, no worse enemy.” From general to private, Marines are expected to govern themselves with the highest standards and the purest of intentions day in and day out. Despite all the new technology, tactics, and cutting-edge gear, survival remains a struggle of the will—destroying the enemy’s while controlling and channeling our own.

Most shortcuts in finance are ill-conceived at best and outright illegal at worst. History is replete with examples of those who pursued shortcuts versus those who stay disciplined and keep it simple, follow their models, and stick to the plan (Warren Buffett and John Bogle are personal favorites). Like most things in life, things worth doing take hard work, persistence, and planning.

We hope that our look back on the lessons learned in the Marine Corps informs how we carry ourselves and our business. We are thankful to have served with such courageous men and women who tried to make a small corner of the world a better place. The world is always changing, but the lessons learned in the military will serve us for years to come. Semper Fidelis!

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Endnotes
1. As of March 31, 2015.

References