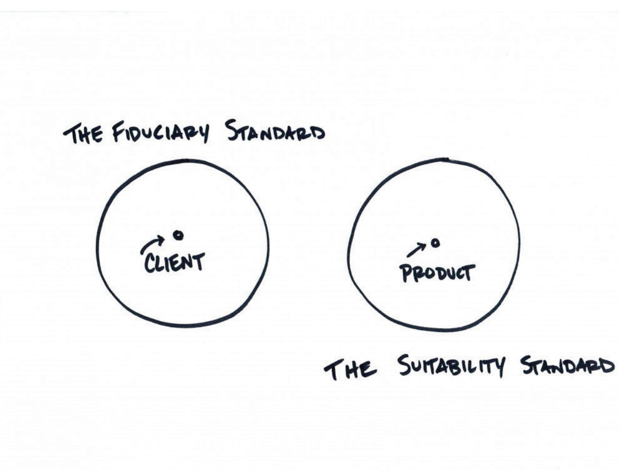
# May 2018 Financial Planning Notes
# Client Newsletter

*"Nothing travels faster than the speed of light, with the possible exception of bad news, which obeys its own set of laws"*
***Douglas Adams***

In This Issue:



## The Commissioned Fiduciary (And Other oxymorons)




There are few things as important in our business than clearly defining **the fiduciary standard** and explaining to clients and prospective clients why it is critically important to hire a financial advisor who is held to that level of care.

The fiduciary standard dates to the Investment Advisers Act Of 1940 (aka "The Act"), which, simply put, said that anyone who is in the business of giving financial advice, and receives compensation for doing so, must always act in the best interest of the client, the person paying them for that advice. That means putting the client's interest ahead of his own.

That seems simple and logical, but since when is the world simple and logical?

There are many exceptions to the rule. "Hold on there, Federal Government. I'm a CPA who primarily does taxes for my clients but occasionally will give them advice on what to do with their cash and investments. Do I fall under The Act?" Well, no. You can have a pass if financial advice isn't your principal business.

"Hey, I'm a journalist. I just write a blog giving general financial advice to many readers. Must I be a fiduciary?" Nah, you're excused too.

"But I'm a commissioned broker. I don't charge my client for the advice I give because I get paid by a fund company when I buy a product for the client. If the client isn't paying me, why should I be held to such a high standard of care?" OK, we'll let you off the hook too.

And just like that, most financial advisors skipped right out from the fiduciary standard.

So, what does the commissioned advisor exemption really mean for investors? That's where understanding the difference between standards of care is important.

Under the fiduciary standard, there are many things an advisor **must** or **must not** do. For example, the advisor:

- **Must** select investments that best meet clients' needs at the lowest cost,
- **Must not** select investments based on how much compensation he stands to receive for the sale, and
- **Must** avoid conflicts of interest,
- **Must** obtain "best execution," finding a broker to conduct trades most efficiently and at low cost.

Commissioned advisors fall under a different standard of care called the **suitability rule**. If the advisor reasonably believes his recommendations are suitable for the client, he's good to go.

So, what's wrong with that? Why isn't it enough to create an investment portfolio filled with suitable investments? That sounds pretty good, right?

Well, in my experience, no. It isn't enough. It isn't even close to enough.

For starters, what is suitable for a client? Are risky derivatives a suitable investment for an 85-year old retiree living on a fixed income? The answer is, obviously, "no." Except if the answer is "yes." Because the real answer to that question is "maybe."

In fact, a very risky investment could be shown to be suitable in even the most risk-averse client's portfolio if it is a small part of the portfolio and can be shown to reduce the overall risk of the portfolio by adding more diversification.

Did that last paragraph make your eyes glaze over? Sorry. Translation: Pretty much **any** investment could meet the suitability standard if the portfolio is well-diversified.

But that's just the start of the potential problems for investors if their advisor is only being held to the suitability standard. While we have a long list of **musts** and **must not** for advisors under the fiduciary standard, there are a lot of **cans** and **probably wills** for the commissioned advisor. For example, the advisor:

- **Can** act as the "principal" in a trade with you, meaning he isn't brokering a sale to or purchase from a third party, but selling directly to you from his own portfolio, or buying from you to hold the asset in his own account,
- **Can** buy a hot stock for himself first then buy it for you after the price has gone up,
- **Can and probably will** recommend high-cost funds when similar lower-cost funds are available, because the high-cost funds pay him better, and
- **Can and probably will** use his own brokerage firm for trades even if they are more expensive than, and don't get as good market prices as other brokers.

These are big problems and conflicts that can be very costly for the client but based on the brokerage business model (and their exemption from The Act) there really is no way to avoid them.

Even if you are not fully enveloped in the world of finance daily as I am, you may have heard the word fiduciary in the news over the last couple of years. Here's the condensed version of what was going on: The Department of Labor passed a rule requiring all advisors to act as fiduciaries for retirement assets. Do you think that was a big deal for the brokerage world? You're darn right it was. And they fought back. And we had an election and a new administration that has been reluctant to enact and enforce the rule. So far, it's been business as usual for brokers, still following the suitability standard.

Commissioned advisors who tell you they act in your best interest are just not being honest with you. Only a "Fee-Only" advisor is held to The Act and truly **must** place your interests ahead of his own.

*Steve*

## Noise-Cancellation Headphones

My latest “million-dollar idea” came to me as I was packing yesterday for a big trip. I was stuffing my little earbuds in my carry-on and remembering how every time I try to use them on a flight, engine and cabin noise always seems to drown out the music on my iPod. (Yes, I still own an iPod. And I have an AOL account. A little respect, please – I’m elderly.)

About the same time, some financial news was blaring. It was whatever big story might have some big impact on the markets sending them up big, or maybe it was down big. Honestly, I can’t remember the story. It was just noise. The noise I’d like to drown out. There is rarely any financial news that will still be important in the next news cycle (i.e., tomorrow) and experience tells me acting on financial news is very likely to lead to investment mistakes.

And then the idea came: financial noise-canceling headphones. Genius! Slip these babies on and you won’t be able to hear a thing they’re saying on CNBC, Bloomberg News or Fox Business. But even better: when you’re scrolling through your favorite news site, you can click on all your favorite tabs: Headlines, politics, sports, local. But the financial news tab is greyed out. You type in a search for business news and you get a 404 error. These are some versatile headphones!

When I return from vacation I’ll be on the lookout for a good engineer to get started on designing a prototype. If you have any suggestions, please email me!

In the meantime, and in the unlikely event we experience a delay getting to market of, say, forever, here are a few slightly lower-tech tips to deal with financial noise:

**Watch**, **read** or **click** for entertainment only,

**Resist** any temptation to call your advisor after watching, reading or clicking (except to share a laugh),

**Remember** some days there is more news than others, but the newspaper always has the same number of pages and the news show always runs the same length of time. How can both be true? Simple: Slow news days bring even more noise. If you aren’t a “noise-to-signal” expert, capable of finding what’s important in a sea of flotsam, don’t try,

**Understand** that most of the financial news, and financial services industries are not trying to inform you. They are trying to get you to **act**, “take action”, and those actions will rarely be compatible with your financial plan or help you achieve your lifelong financial objectives, and

**Focus** on the non-daily news. Weekly or even monthly publications will (at least theoretically) do a better job of filtering out the noise and only including what has stayed important across multiple news cycles.

So, the earbuds are packed, along with a swimsuit, flip flops, and lots of sunscreen. Maui, here we come!

*Steve*

Financial Planners is a fee-only financial advisor and sells no investment products.

## Fraud Alert

We take the protection of your hard-earned assets seriously and strive to keep up to date on and inform you of, the latest fraud and theft scams going on. Recently, we received an alert from our compliance service of an SEC-related scam.

The SEC, or Securities and Exchange Commission, is the regulating body for a great variety of financial transactions, including stock trading.

If your email is compromised, a hacker may see that you received a trade confirmation from TD Ameritrade or Charles Schwab or from us. They may then contact you posing as the SEC and ask to confirm the trade by requesting account details.

The SEC has issued an Investor Alert saying that they do not contact investors to confirm trades, set up accounts or record trade details. Never provide account details on the phone or via email, and of course, don't send anyone money.

If you suspect someone is impersonating the SEC to defraud you, contact us immediately, as well as the Office of the Inspector General at 877-442-0854.

## Who We Are

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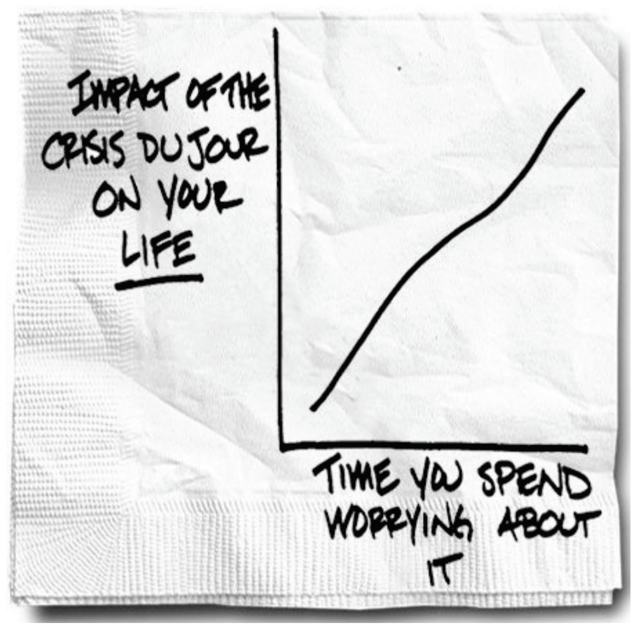
## From Carl Richard's Napkin Blog




## Final Thought


"You are what you eat, so my advice is to eat a lot of rich food."