



Napa Wealth Management's The Sensible Investor

June 2011

Does Conflict-Free Investment Advice Exist?

Next Newsletter: July 2011

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In a word, "No". Every financial professional has a conflict of interest associated with their advice. Let's explore these conflicts to learn how they may affect you.

We begin by identifying how the financial professional, the registered representative (titles such as broker, financial advisor, financial consultant or financial planner) and the registered investment advisor (RIA) operate. The main difference: a RIA has a responsibility to you – a registered representative may not. We'll dig deeper into the issue of responsibility in a moment.

At the nexus of the client/financial professional's relationship is compensation – how is the advisor paid? John Gannon, senior vice president for investor education at FINRA, the independent regulatory body for brokers says, *"Financial professionals are paid. And regardless of whether you're dealing with a broker or an adviser (RIA), there's an inherent conflict of interest there, and you need to know it."* Given the fact that a compensation conflict exists with brokers and RIAs, one must examine how the financial professional is paid and with whom that professional's allegiance lies.

Brokers execute clients' buy and sell orders. Financial planners will commonly purchase or sell mutual funds or Exchange Trades Funds (ETFs) for their clients in the context of an asset allocation model (diversified portfolio). A commission is paid to the financial professional for executing the transactions. This is essentially a sales agent relationship because the broker and financial planner work for the brokerages (broker/dealer firms). And while they may have their clients' best interest at heart, it is not a legal requirement to do so, and therefore investment products they recommend must merely be "suitable" for the investor.

The conflict becomes magnified as you consider that brokers and financial planners are free to recommend an investment that pays a higher commission for themselves, even if another suitable investment is safer or offers a better opportunity for the investor. When sales incentives or job security issues drive a registered representatives recommendations, his/her client's interests might suffer.

A RIA has a fiduciary duty to place a client's interests ahead of his/her own. Still, an RIA could be earning a commission for recommending a certain product, but he or she would typi-

cally have to be registered dually as a broker and as a RIA. A RIA is typically paid a management fee as a percentage of assets (investments) the RIA manages. Obviously the RIA is paid more as more money is placed under his/her management. Consider a scenario where an investor wants advice about investing in a real estate rental or placing more money under a RIA's management - a conflict exists since the RIA is not compensated if the money is used to buy real estate. There are RIAs that will charge you an hourly fee for advice but they are rare. In order for the hourly fee arrangement to work, you either manage your own investments, or hire someone to manage them for you which bring you back in the compensation conflict arena.

Even when managing one's own investments, a conflict exists. The conflict is transferred from a compensation conflict to an emotional conflict. In 25 years working in the financial business, I can recall countless stories of mistakes that investors have made managing their investments because of a "feeling", by purchasing a stock because a friend recommended it, or a stock that they didn't sell because of one reason or another which cost them dearly. *"People's opinions and gut feelings are often wrong"*, wrote Bill O'Neil, founder of Investor's Business Daily newspaper and author of *"How to Make Money in Stocks"*. Managing one's own investments can work but it isn't without conflict.

Since conflict-free advice doesn't exist, ask the financial professional to disclose them. Ask how they are paid. If a commission is their source of compensation, drill deep to make sure you are comfortable with their recommendations. When a management fee is involved, find out if there are breakpoints for discounts. Find out who pays the transaction fees. If the advisor pays them, ask if she will be compelled to not trade because it might reduce her profitability.

When searching for advice in which a financial professional is not compensated, (think about my real estate example earlier) obtain solid rationale for the answer. It should be sensible and feel right to you. If you don't know the financial professional, get several references. It is time well invested.

Most financial professionals will not be insulted by being asked the "hard" questions. They have a vested interest in the relationship with their clients. If you are not comfortable with their answer to your questions, find someone else to interview. Understanding where the conflict exists will help both the client and advisor enjoy a harmonious working relationship.

Keep looking up - George



Busting Financial Myths

Part-3

By Tim Ayles,

Chief Investment Officer

If Money Printing is Good, Then Just Print Enough To Give Everyone \$1 Billion.

If printing is not a big deal, then why not just print away? The doom and gloomers jump to the conclusion that if I think printing won't cause the collapse of America, it must be a good thing. So why not seek more of that good thing? The answer is simple.

There is a limit to the productive capacity of the economy. If the government printed money to buy 40 million cars, and gave that new money to Americans on the condition it only be spent on automobiles, Americans could do one of two things, buy cars or sit on the cash. If the capacity of the world's auto manufacturers is 20 million cars, and the government printed enough money to buy 40 million cars, the market's ability to produce only 20 million cars would be overwhelmed by car demand - thus creating a price surge. In a perfect environment, this price surge would bring demand in line with production. If the demand happened overnight, we could be certain that the price of a car should, at a minimum, double overnight. 20 million cars would be produced because that is the capacity of the market, but the price would double to soak up the new money that was printed to buy 40 million cars at yesterday's prices. Of course, new wealth could be created from all of this printed money if other firms decided to take free resources, like iron ore, and convert it into steel to make more cars to meet this demand.

So the answer as to how much money printing we can handle is this: how much demand for goods will the printing create for the economy? If everyone received \$1 million but took a vow to never spend it and instead put it under their mattress, I doubt prices would move much, because the demand is not there. If the economy gets to maximum production, then new money in the system via demand will cause the rise of prices across the board.

We are seeing some of this happen now with food prices in certain areas of the world. Capitalism will, over time, right this ship through. Farmers will see the ability to make more money selling beans and wheat, and will invest in planting more acres for these crops. They will purchase technology that will help reap more crop yield per acre. Right now there is an imbalance, but it won't last. The doom and gloom crowds will have you believe that this current "crisis" is permanent, causing the collapse of society as we know it. No need to fear, but in the meantime while the imbalance is in place, buy the businesses that turn the commodities into wealth. Don't buy oil itself, but Exxon or Chevron. Don't buy wheat or soybeans, buy fertilizer companies which allow farmers to produce more wheat and agriculture, companies like Potash. But always make sure the current profitability of the company is worth investing in. If you invest with the idea that the crisis will be without end, you may end up overpaying for a stock.

America Will Soon Not Be Able to Afford the Interest on the National Debt.

"A major depression is inevitable for America because decades of growing debt-financing by consumers, businesses, and state and (especially) federal governments have undermined the health of the economy, giving the appearance of wealth when in fact there is poverty. The enormous private and public debts bring the law of compound interest into play, and it takes no great mathematician or economist to figure out that those who live beyond their means for too long must finally reach the point at which they not only cannot pay off their debts, they can't even pay the interest on them—or find anyone willing to lend enough to cover the interest." (www.ecalvinbeisner.com/reviews/BurkettReview.pdf) Does that sound like anything you may have heard in the past few years during the financial crisis?

The statement in quotations above is doom and gloom from Larry Burkett in his book about the coming financial earthquake back in 1990! This quote was spoken into existence when the federal debt level stood at only \$4 trillion. He was wrong 21 years ago, and I would imagine those who are selling this idea will most likely be wrong 21 years from now. When the American economy doubles in 30 years, and the national debt stands at \$30 trillion, can you imagine the siren bells that will be sounding then?

Burkett prophesied that America, by the turn of the century, would have so much debt that they could not afford the interest on the debt. Since his book made this claim, the debt has nearly tripled. Now the current doom and gloom crowd is saying, yet again, that we will not be able to afford the interest on the debt. They conclude impending collapse is right around the corner. We are warned foreign confidence in the US Dollar will cease, and they will sell Treasuries indiscriminately, causing an epic collapse in our bond market which leads to 'economy-choking' higher interest rates. High interest rates, of course, will supposedly mean the US Government can't afford the interest on the outstanding debt because it is so large.

Other versions of fear and doom might sound similar to these:

"In their ill fated attempt to get something for nothing the Fed is going to cause a currency crisis and a massive surge in global inflation."

"The price we will all pay when the house of cards comes crashing down again will be multiples more expensive than last time."

"The problem is debt. Hyperinflation is the result of a government debt spiral. At some point the debt becomes so large that a nation can't even service the interest on the debt. At that point there are only two options. Either default or inflate."

Oh me, oh my, the sky is falling! Sell everything and buy gold is what they sell you in their newsletters! My advice? Cancel your doom and gloom subscriptions. The US Government is not revenue constrained. For those who want to find out why, I highly encourage you to read: [Understanding Modern Money](#) by L. Randall Wray. Worry about the deficits once factories are at capacity. At that point, the government will use their tools (taxes, rates) to slow down the economy.

Disclosure: NWM owns Exxon, Chevron and Potash in client accounts. This is not a recommendation to buy or sell any security mentioned.