April 13-17, 2015

# InvestmentNews

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**Dumping clients**
Fidelity is teaming up with another firm to help RIAs profitably offload unprofitable clients. **Page 2**

# Arca glitch 'big deal' to ETF crowd

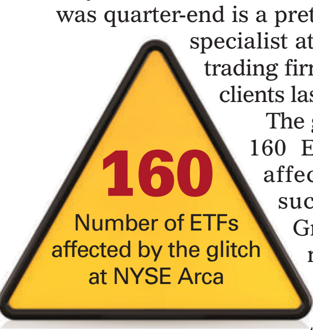
*1Q results of many funds skewed by issue with server*

**By Trevor Hunnicutt**

Advisers and investors this month are seeing surprising and, in many cases, misleading, first-quarter returns as a result of an electronic-exchange glitch that affected some high-volume exchange-traded funds.

As a result of the computer-server difficulties on March 31 at the New York Stock Exchange Arca, the typical amount of information about buyers and sellers around the time the market closed was not provided, according to traders.

That "caused some of these funds to close way off their fair value, which considering it was quarter-end is a pretty big deal," an ETF specialist at KCG, a Wall Street trading firm, wrote in a note to clients last Monday.




The glitch affected about 160 ETFs in all. Those affected included firms such as The Vanguard Group Inc., and investment-adviser clients who use the providers' ETFs. Firms that traded the products may have received poor pricing, and even those that didn't were stuck with funds whose prices swung dramatically from the actual underlying value of the securities they held.

One firm feeling the impact was Bank of America Merrill Lynch, according to Jon D. Maier, who runs scores of ETF-based portfolios for some of the firm's 14,000 financial advisers.

A large position in a fund affected by the exchange issue, the Vanguard Growth ETF (VUG), caused the performance of one of Merrill's portfolios to drop by some 70 basis points, Mr. Maier said.

One hundred basis points equals 1%. In the world of tactical asset allocation — an active-management strategy where success is fleeting and almost every basis point of "excess return" or "alpha" beyond a benchmark is valuable — that's a sizable figure.

Mr. Maier discussed the incident at an industry conference in New York on April 1, a day after it occurred. Merrill declined to comment further through a spokeswoman, Susan McCabe.

**BACK TO NORMAL**

The funds have since bounced back to normal trading, meaning any artificial high or low performance has been corrected in time for future reporting periods. And the scale of the

**Continued on Page 26**

**Ron Kruszewski:** "When I look at the dynamics of what's occurring with the LPLs and the Raymond Jameses of the world, it's obvious it's a growing channel."

DAN DONOVAN

# SHOPPING SPREE

*Stifel's purchase of Sterne Agee likely not its last in B-D space*

**By Bruce Kelly**

THE ACQUISITION of the Sterne Agee Group by Stifel Financial Corp. was classic Ron Kruszewski: find a company in turmoil and buy it on the cheap.

It is a strategy that has served the Stifel chief executive well over the past 18 years. Largely through a series of acquisitions — 16 in the past 10 years alone — the 56-year-old Mr. Kruszewski has transformed a small regional brokerage with $123 million in revenue in 1997 into a full-fledged financial services company that had $2.2 billion in revenue last year.

Mr. Kruszewski's deal for Sterne Agee, which was announced in February and is expected to close later this month, signals Stifel's interest in growing its wealth management business. The acquisition will add $20 billion in assets and 730 advisers to Stifel, which will bring its total adviser workforce to 2,800. That pales in comparison to the wirehouses and large independent broker-dealers, but Stifel may not be done making acquisitions.

"In the independent adviser and broker space, we're in it, but we're small," he said in an interview. "But when I look at the dynamics of what's occurring with the LPLs and the Raymond Jameses of the world, it's obvious it's a growing channel."

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**advisers on the move**

Wirehouses are holding their own in the recruiting wars.
**First-quarter recap, Page 4**

## EDITOR'S NOTE

# Wirehouses doing better than before

Wirehouses are putting up one helluva fight. Every week, *InvestmentNews*, and many of our competitors, run stories about advisers who break away from wirehouses to go independent. We write these stories because they tend to involve lots of assets and interesting people. These stories also are naturally imbued with an element of drama that stems from the fact that someone — or more likely, some team — is putting it all on the line in pursuit of independence from "the man."

Frederick P. Gabriel Jr.

You read these stories — and trust me, you do — for all the same reasons. You also read them because you probably once worked for one of the Big Four and, therefore, still take an interest in who's leaving and the firms' efforts to stanch the exodus of brokers.

But despite all the reported moves, wirehouse efforts can't exactly be described as failing.

Our quarterly look at broker migration in and out of the wirehouses, which can be found on **Page 4**, clearly shows that wirehouses are doing a better job of keeping brokers within arm's reach. Indeed, 60% of broker moves in 2014 involved brokers who traded one wirehouse for another. While that's way down from the levels of intrachannel movement that we saw pre-2008, it's an improvement from 2011, when 57.3% of brokers moved from wirehouse to wirehouse.


More important, our data show that wirehouses are doing a better job of retaining client assets. In 2014, wirehouses managed to keep hold of 60.3% of exiting brokers' books of business, up noticeably from a little over 54% in 2012.

### BIG BONUSES

Clearly, wirehouses are not going the way of the dodo bird.

As long as there are huge signing bonuses for joining wirehouses, there will be big brokers to staff them. Incidentally, some top advisers are raking in 150% of their annual revenue when they sign on that dotted line and join another wirehouse, according to our story.

I encourage you to read the story. I also encourage you to check out our Advisers on the Move database at InvestmentNews.com/aotm. There you will find the most up-to-date listing of broker drama.

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# Fidelity's plan to offload clients

**By Alessandra Malito**

Fidelity's clearing and custody division is teaming up with registered investment adviser FirstPoint Financial to make it easier for advisers who custody assets on its platform to offload unwanted clients.

FirstPoint Financial, a subsidiary of RIA firm Mariner Holdings Inc., will help advisers review individual clients to determine whether those clients are a good match for their practice. If they are not, the adviser may refer those clients to FirstPoint in return for an ongoing referral fee.

Advisers who refer clients to FirstPoint will receive 35 basis points on the annual revenue earned by those clients' assets. That's more than the 25 basis points FirstPoint pays to non-Fidelity advisers for making similar referrals.

### 'NOT RICH YET'

"We have observed from practice management that one of the top three issues advisers say is 'I don't know how to serve this client efficiently,'" said David Canter, executive vice president of practice management and consulting at Fidelity Clearing and Custody.

One type of client likely to be referred to FirstPoint is millennials, Mr. Canter said.

"These investors may have all the prospects of being millionaires of tomorrow, but they're not rich yet," he added. "They may not fit within the typical spectrum of an advisory firm's clientele, so these emerging and mass affluent

**Continued on Page 22**


COMPOSITE, ISTOCK

# NH seeks $3.6M in fines from LPL

**By Mark Schoeff Jr.**

New Hampshire securities regulators want LPL Financial to shell out $3.6 million in fines and repayments to investors for allegedly unsuitable sales of real estate investments to elderly clients.

In an action filed last Monday, the New Hampshire Bureau of Securities Regulation said it is seeking $2.4 million from LPL in buybacks and restitution for clients in 48 sales of nontraded real estate investment trusts that date back to 2007. It also is imposing a $1 million fine and asking LPL to pay $200,000 in investigative costs.

The state alleges the sales were "unsuitable and unlawful" and that LPL failed to supervise its agents.

The case stems from an 81-year-old New Hampshire resident who bought a nontraded REIT from LPL in January 2008 and subsequently lost a substantial amount on the product, which typically is illiquid and comes with high fees.

The client invested $253,000 in the REIT and had a liquid net worth of $2.5 million. New Hampshire said that investment, and many others, caused elderly clients to hold a higher percentage of their portfolios in risky alternative investments than is allowed by LPL's internal rules.

### EXCEEDED GUIDELINES

The 48 REIT sales that totaled approximately $2.4 million "resulted in an [alternatives] concentration that blatantly exceeded LPL guidelines," the New Hampshire securities bureau wrote in its petition. It received the initial complaint in the fall of 2013.

LPL will request a hearing in front of a bureau hearing officer, according to Brett Weinberg, a spokesman for the firm. A final decision has not yet been made in the case.

LPL was "unable to reach a mutually agreeable resolution" with the state, Mr. Weinberg said in a statement. "LPL has dedicated substantial resources to addressing these legacy issues and enhancing our practices around the sale and supervision of alternative investments," he added.

Adrian LaRochelle, a staff attorney in the New Hampshire securities bureau, said it has been talking to LPL throughout the investigative process.

"We believe there's a serious enough problem that a hearing is necessary," he said.

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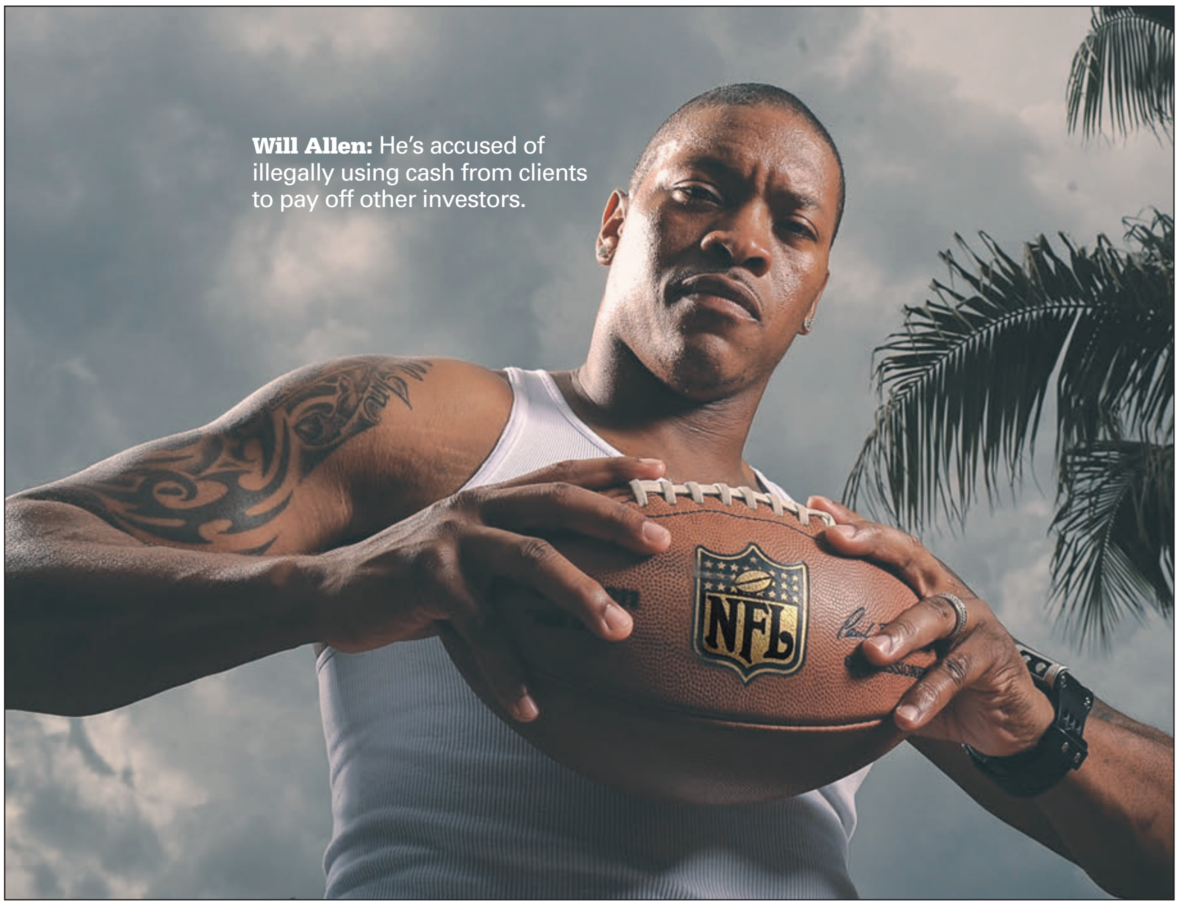

**Will Allen:** He's accused of illegally using cash from clients to pay off other investors.

GETTY IMAGES

# Ex-player charged with Ponzi scheme

**Bloomberg News**

U.S. regulators sued former NFL cornerback Will Allen over claims he helped run a Ponzi scheme that promised investors profits from loans to professional athletes.

From July 2012 through February 2015, Mr. Allen and his partner used cash from some clients to fill a $7 million shortfall in payments to other investors, the Securities and Exchange Commission said in a complaint unsealed Monday in Boston federal court. The court froze assets associated with the alleged scheme, and the SEC is seeking additional penalties.

"The defendants sold investors on the idea of lending money to pro athletes, but we allege that's not where a large portion of the investors' money went," Paul Levenson, head of the SEC's regional office in Boston, said in a statement. "As in any Ponzi scheme, the appearance of a successful investment was only an illusion."

Mr. Allen, 36, was drafted in the first round by the New York Giants in 2001 and played for the team until 2005 before joining the Miami Dolphins, according to the National Football League. Mr. Allen graduated from Syracuse University, where he still holds some defensive records.

### OUT OF BOUNDS

Mr. Allen and his partner, Susan Daub, raised more than $31 million from investors to make the loans to athletes that they said would earn as much as 18% interest, the SEC said. The agency said they misled investors about the terms, circumstances and even the existence of some of the loans and then used some investor funds to pay personal expenses at casinos and nightclubs.

A woman working at one of Mr. Allen's companies, Simplified Health Solutions, said he wasn't available to comment. Ms. Daub is also charged.

# SEC alleges fraud

## *Says clients were misled about life settlements*

**By Mark Schoeff Jr.**

The Securities and Exchange Commission has charged a Los Angeles investment firm with fraud and securities violations surrounding investments tied to life insurance policy death benefits.

The SEC alleges Pacific West Capital Group Inc. and its owner, Andrew B. Calhoun IV, a Beverly Hills life insurance agent, misled clients about investments in so-called life settlements. In those vehicles, an investor buys a share of a life insurance policy and later receives part of the death benefit.

In a claim filed in U.S. District Court for the Central District of California, the SEC said that since 2004, Pacific West and Mr. Calhoun raised nearly $100 million from more than 3,200 investors who bought life settlements in 125 life insurance policies.

Since 2012, the SEC asserted, Pacific West and Mr. Calhoun used the proceeds from the sale of new life settlements to pay the premiums on life settlements sold in previous years. They hid from investors the reality that the life insurance policyholders were living longer than expected, drawing down Pacific West's premium reserves, the SEC said.

### HIDING RISKS

"Investors are entitled to fair disclosures about the risks associated with their investments," Michelle Wein Layne, director of the SEC's Los Angeles Regional Office, said in a statement. "We allege that Pacific West and [Mr.] Calhoun did the opposite here by hiding and minimizing those risks in order to sell more life settlements."

The SEC said Pacific West glossed over the risks associated with life settlement investments. The firm said the life settlement policies would mature in four to seven years and pay a return of 100% to 150%. It also said it never drew on premium reserves or made a premium call to investors, according to the SEC complaint.

"Since at least 2012, Pacific West and [Mr.] Calhoun have misrepresented the risks that investors would have to make future, out-of-pocket payments to keep the policies in force, and failed to disclose material information about the increased amount of future premiums," the SEC stated in its complaint.

The SEC is seeking an injunction against Pacific West, which is not registered with the agency, and Mr. Calhoun, and is trying to recover fraudulent gains and civil penalties.

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# Energy mergers aren't a sign to jump into sector

**Jeff Benjamin**
On Investments

Despite its size, Royal Dutch Shell's $70 billion acquisition of natural gas giant BG Group is far from a green light for investors to jump headlong into energy, even as some M&A experts forecast a wave of mergers in the industry.

As entry points go, energy is very much a stock-pickers market, which is not to suggest that money cannot be made investing in the category right now.

Exhibit A is the recent performance of energy sector mutual funds, as tracked by Morningstar Inc. The painful ripple effects of oil's six-month nose dive have produced a 12-month average decline for the fund category of 16.6%, including a range from barely negative to down 45.9%.

Meanwhile, the S&P 500 is up 14.8% over the past 12 months, but just 1.4% from the start of the year.

### TRYING TIMES

"Minus the last 60 days, the last 18 months have been difficult for the energy sector, and active managers in the space have been beaten down," said Steven Wruble, chief investment officer at FolioMetrix. "Energy

Continued on Page 22



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1ST QUARTER RECAP

# Wirehouses have put the brakes on breakaways

*60% of moves in 2014 were from one Big Four brokerage to another*

By Mason Braswell

Despite the growing list of options for advisers who want to break away from the wirehouses, the Big Four are holding their ground in the recruiting war for veteran advisers and account for the majority of the deals in the industry.

Those who traded one wirehouse for another, including Bank of America Merrill Lynch, Wells Fargo Advisors, UBS Wealth Management or Morgan Stanley Wealth Management, accounted for about 60% of adviser moves last year, as tracked by *InvestmentNews*' Advisers on the Move database.

**ON THE WEB**
Track the latest adviser moves and recruiting activity at InvestmentNews.com/aotm

### SHARE STEADY SINCE 2011

The 60% figure is lower than it was in 2008, when an estimated 80% of advisers who moved jumped to another wirehouse, according to estimates by industry recruiter Danny Sarch of Leitner Sarch Consultants.

But the number has remained relatively steady or ticked up slightly since the database began tracking moves in 2011, when 57.3% of advisers moved from wirehouse to wirehouse.

And the wirehouse channel isn't giving up as many assets under management, either. The amount of assets leaving wirehouses for independent firms has been falling steadily in recent years, from 45.9% (leaving advisers' books) in 2012 to 39.7% last year. Already in the first quarter this year, wirehouses have held onto 51% of the $7.9 billion of assets in motion, according to the database.

"What we've seen so far this year is a lot of larger teams moving, and sometimes those teams feel that they are best accommodated by another wirehouse," said Bill Willis, an industry recruiter who has done work with some of the wirehouse firms. "The old guys my age like the security of the wirehouse."

The numbers in the database track only the larger moves of the industry, most of which are over $100 million, so it is not a comprehensive list of all moves. But it does reflect that wirehouses are holding onto some of the largest teams in the industry, even as independent channels increase their focus on $1 billion-plus breakaway teams and critics bemoan continual compensation changes and increased compliance hurdles.

> "THE OLD GUYS my age like the security of the wirehouse."
>
> **Bill Willis**
> Industry recruiter

Bank of America Merrill Lynch, for example, started the quarter picking up a $1.2 billion team, including longtime Morgan Stanley veteran Bruce Munster.

As of the most recent quarterly reports, the four major firms accounted for approximately $7 trillion in assets under management and about 52,000 advisers.

Wirehouses have been able to keep big producers in their channel, recruiters say, because they have continued to pay big signing bonuses.

BLOOMBERG

### 'VERY AGGRESSIVE'

"I've seen in competitive situations that they're very aggressive," Mr. Sarch said. "The wirehouses have upped the deals somewhat, which makes it easier for [advisers] to think about the wirehouses."

The deals for a top adviser can be more than 150% of their annual revenue. Wirehouses keep billions in recruitment and retention deals on the books, although it can take several years for those deals to pay off.

In addition, while independent firms have been hoping to benefit from a wave of retiring advisers, the wirehouses have also been sweetening retirement deals for advisers, which can be persuasive to some of the older advisers making a move, Mr. Willis said.

Many are looking at a "double payday" if they move to another wirehouse and then benefit from the sunset program at that wirehouse when they retire, he added.

Mr. Sarch said that independence may offer a better long-term payout given the adviser owns his or her business, but that the move is not as seamless as joining another wirehouse.

"Everyone asks about independence," Mr. Sarch said. "But it's not for everybody."

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## 1st Quarter

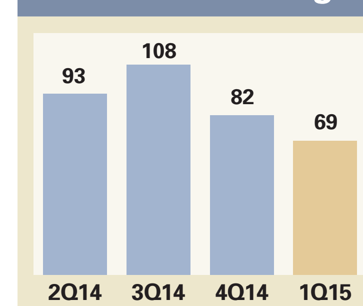
### Top-ranked firms by net change in AUM

| | AUM ($M) | | | # of teams | |
|---|---|---|---|---|---|
| | Gained | Lost | Net change | Gained | Lost |
| Raymond James | $2,869 | $0 | **$2,869** | 12 | 0 |
| Bank of America Merrill Lynch | $2,548 | $300 | **$2,248** | 7 | 3 |
| United Capital | $2,000 | $0 | **$2,000** | 1 | 0 |
| Wells Fargo Advisors | $1,673 | $533 | **$1,140** | 7 | 4 |
| Independent Financial Group | $1,115 | $0 | **$1,115** | 4 | 0 |

### Lowest-ranked firms by net change in AUM

| | AUM ($M) | | | # of teams | |
|---|---|---|---|---|---|
| | Gained | Lost | Net change | Gained | Lost |
| Morgan Stanley Wealth Mgmt. | $975 | $5,113 | **-$4,138** | 5 | 24 |
| Compass Bank | $0 | $2,000 | **-$2,000** | 0 | 1 |
| UBS Financial Services | $0 | $1,990 | **-$1,990** | 0 | 9 |
| BNY Mellon | $0 | $850 | **-$850** | 0 | 1 |
| RBC Wealth Management | $0 | $638 | **-$638** | 0 | 3 |

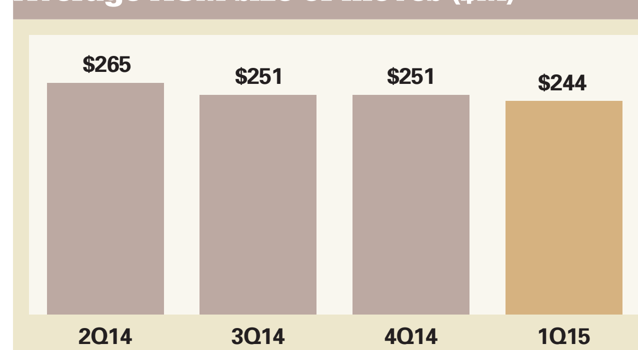
### Total teams moving




### Top moves in the first quarter

| | Name of advisers | Adviser AUM ($M) | Firm adviser is leaving | Firm adviser is joining | Location of adviser |
|---|---|---|---|---|---|
| 1 | Stephen Dreiling, Jason Rosener, Chris Johnson, Brian McDowell | $2,000 | Compass Bank | United Capital | Denver |
| 2 | Bruce C. Munster | $1,200 | Morgan Stanley Wealth Management | Bank of America Merrill Lynch | Los Angeles |
| 3 | Raymond E. Ifert, Lorraine M. Faedo | $850 | BNY Mellon | Raymond James | Tampa, Fla. |
| 4 | Pat Callaghan, Alan Fishman, Bernard Neuman, Jonathan Neuman, Tom Puccinelli, Stan Slovin, Lisa Su, Irene Kapusciarz, Melissa Vald | $700 | Morgan Stanley Wealth Management | Wells Fargo Advisors | Deerfield, Ill. |
| 5 | J. Samuel Fitch | $597 | Warren Averett CPAs and Advisors | Bridgeworth Financial | Birmingham, Ala. |

### Average AUM size of moves ($M)




CHARTS: GERARDO TABONES

**Source:** *InvestmentNews* Data

To submit an adviser move, complete the form at data.InvestmentNews.com/aotm

# VIEWPOINT

## EDITORIALS

# Advisers can't live by AUM fees alone

IT'S TIME for financial advisers to rethink the AUM fee — fast.

Charging a percentage — usually 1% — of assets under management has long been considered the most ethical, and profitable, way to get paid for delivering financial planning and investment advice to clients. That explains why 95% of investment advisers set fees based on AUM, according to the 2014 *InvestmentNews* Financial Performance Study of Advisory Firms.

It also explains why fee-only financial advisers have long commandeered the moral high ground over their commissioned brethren when it comes to touting the virtues of their respective compensation models.

But, as more clients shift from accumulating assets to spending those assets down in retirement, it is fast becoming clear that the AUM model has conflicts of its own. One of the biggest is that it encourages advisers to hold on to assets. That raises the possibility that a client might be discouraged from liquidating an investment, let's say, in order to buy a second home, because the move would not be in the adviser's best interest.

### LIMITING THE REACH

Another problem with the AUM model is that it discourages financial advisers from reaching beyond high-net-worth individuals into the middle class when they prospect for clients. By ignoring modest earners, advisers are closing themselves off to a large segment of the market — possibly to the detriment of their own practices.

Finally, the AUM model faces an even bigger problem. That problem stems from the fact that it places advisers in the position of charging too much for investment advice and too little for financial planning. As a result, it encourages clients to value advisers for their ability to invest assets in the markets, rather than for helping them achieve long-term financial goals.

With the emergence of so-called robo advisers, which offer investment advice for 35 basis points or less, that's a precarious position for advisers to be in. After all, why should clients pay a financial adviser 1% of assets under management, when an electronic advice platform can manage the same assets for a fraction of the cost?


### PLANNING BASED

The answer, of course, is that financial advisers do much more than dispense investment advice — at least, the good ones do. In addition to basic financial planning, good advisers keep clients from making stupid mistakes — such as socking away too much money in college funds and too little in retirement accounts, or bailing out of the markets at the worst possible moment.

**FINANCIAL ADVISERS** do much more than dispense investment advice.

So how do these advisers get clients to recognize — and more importantly pay for — the work that they do beyond managing their investment portfolios?

The answer is to transform their practices into ones that offer services based on financial planning and to assign a hard dollar value to those services. Not only would such a transformation help advisers generate new revenue, it would force them to pay close attention to the value, and level of service, they deliver to clients.

It would also require them to incorporate other pay models into their practices. Those models would run the gamut from annual retainers to a la carte pricing to hourly rates and even subscription-based services. Adding other pay models would make it easier, and more profitable, for advisers to reach the middle class and the all-important millennials.

Let's be clear: We are not advocating for the demise of the AUM fee.

Just like the commission-based model makes sense for some investors, so does the AUM model. That's especially true when it comes to high-net-worth investors — many of whom pay far less than 1% on their assets due to the size of their portfolios.

Our point is that clients should have the option of paying for financial planning and investment management in a way that makes them most comfortable and makes sense for their stage of life. The prevalence of the AUM model means that these alternative models — though they are out there — are more difficult to find.

Reduced dependence on the AUM model is also good for the advice industry. The rise of robo advisers calls into question the future of advisers who base their value solely on investment management.

Financial advisers who take seriously the fact that pure investment advice is being commoditized, and expand and fairly price financial planning services they provide, will not only prosper but will better serve their clients.

# Optimizing your site can give you a leg up

You've heard this warning ad nauseam: Update your website or perish. This time it might be true.

When Google announced recently that its latest algorithm change would favor mobile-friendly websites in search results, the need for refinement became much more than just the usual plea for cosmetic appeal.

Our technology reporter, Alessandra Malito, wrote in late March that Google's new approach, which will go into effect April 21, means advisers' sites will need to be optimized by that date to continue ranking high when potential clients try to find them in Google searches.

"Websites are like modern-day yellow pages," Chris Horton, a digital strategist at SyneCore, poignantly explained in Ms. Malito's story. "If you weren't in the yellow pages, people didn't do business with you. They didn't trust you."

### THEY GET IT

Advisers get this. According to the 2014 *InvestmentNews* Financial Performance Study of Advisory Firms, "firm's website" was chosen by far (65%) as the most successful marketing tool.

**IT'S NO LONGER** enough to have a snazzy site that looks great from a desktop.

Despite this fact, only 44% of advisory firms report having websites that are optimized for mobile use, according to the 2015 *InvestmentNews* Adviser Technology Study.

It's no longer enough to have a snazzy site that looks great from a desktop.

As Ms. Malito reported, a Google study found that 94% of smartphone users look for local information from such devices. Your site needs to be at their fingertips — literally.

But don't look at this compulsory renovation as a burden.

Instead, because relatively few of your competitors' sites are mobile-friendly, your website will have a better chance of standing out in the crowd if you make the effort to adapt. This new Google ranking factor — which identifies mobile-optimized sites as "better" — can actually give your firm a leg up where you didn't previously have one.

So take the time to get your site mobile-ready, and make sure the content on it is easily readable and navigable by all those potential new clients out there looking for you.

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VIEWPOINT

# Regulation is only part of the solution

OTHER VOICES
Sean Walters

Recently I spoke on a panel in Australia with Joel Cohen, the prosecuting attorney depicted in the movie "The Wolf of Wall Street." Mr. Cohen, the other panelists and I were asked how our industry — particularly holistic advisory professionals — might emerge from the shadows created by a few bad actors over the past 30 years.

After the panel, it occurred to me that there is no single cure to the reputational issues facing our industry. Indeed, much like the four fundamental forces of nature (strong, weak, electromagnetic and gravity) I believe there are four forces that, when acting in concert, might do much to repair or restore our industry's reputational status: legal and regulatory forces, market forces, industry forces and personal ethical forces.

In his hugely popular Harvard course on justice, which is available on the free edX platform operated by Harvard and MIT, Professor Michael Sandel argues, "A single rule or principle is not the only way, not even the best way, of reasoning about right or wrong, or justice." His point is a good one. When faced with environmental, physical, emotional and financial temptation, one needs to muster all available forces to constrain oneself from misbehaving.

JANET ATKINSON

### VICTIMLESS CRIME

There are countless articles and perspectives on our industry's regulatory and statutory constraints. On our Australia panel, Mr. Cohen offered a view from the prosecutor's table. He lambasted "The Wolf of Wall Street," claiming the film depicted victimless crimes, glorified the upside of the crimes and made it appear to other potential criminals that the downside had only nominal consequences compared with other crimes.

Jordan Belfort's fraud affected 1,513 victims and he served 22 months of a three-year prison sentence. That's less than what most muggers would get for snatching a purse. Mr. Cohen argues for heavier sentencing, clearer and tougher laws protecting consumers, and less red tape for prosecutors in pursuit of "the bad guys." All as one might expect from a former prosecuting attorney.

One of my co-panelists, John Hempton from Bronte Capital, identifies and shorts fraudulent stocks around the world (including many listed in the U.S.). His approach is to follow the unethical players from company to company — including lawyers, executives and brokers who repeatedly work with fraudulent companies — and leverage market forces against unethical behavior. A huge benefit of this approach is that it serves to expose rotten behavior before too much damage is done. This market-driven lens identifies bad actors, shorts their stocks and allows market forces to force the demise of the company.

A third force is industry-driven. I applaud the efforts of the CFA Institute and its Future of Finance campaign, a long-term global effort to shape a trustworthy, forward-thinking financial industry that better serves society. By focusing on the industry, it aims to create an environment in which investors' interests come first, markets function at their best and economies grow.

Unfortunately, we are still a highly fragmented industry. Perhaps in the spirit of competition, those in our industry relish tearing down competing business models. To the outside world, an "independent team" at Wells Fargo and an "independent firm" with Fidelity as its custodian do not appear that different. Yet these two models have been constantly at odds for more than 20 years.

Some advisers physically recoil (often in front of clients) if they are referred to as a stockbroker or insurance agent — even if they offer those very services! Industry groups fight tooth and nail over variations on the theme of "client-centricity." We have no single industry association, nor any unified coalition of associations, generating positive dialogue as an industry. The discord and infighting continue as the shadow of ill repute grows longer.

**THE DISCORD** and infighting continue as the shadow of ill repute grows longer.

### ETHICS AND CERTIFICATION

The final force is that of professional ethics — the personal, organizational and corporate standards of behavior expected of professionals. My role on the panel in Australia was to discuss the link between voluntary certification and ethics. I was quick to note that ethics and certification are not bonded by a causal relationship. I haven't seen any study demonstrating ethical behavior to be higher for professionals who hold a certification or lower for those who do not.

However, the voluntary act to pursue and uphold a higher standard than what's legally required through state or federal licensure is inherently ethical. When professionals earn (and maintain) a rigorous certification, they voluntarily adhere to higher standards — including, in most cases, a code of ethics that represents higher standards than what is required by law or regulation.

Consider the principle of integrity. Certainly honesty or truthfulness is essential for a trust profession like financial advice, but I am referring in this instance to product or service integrity, which is defined as "wholeness or completeness." All professionals as a matter of integrity should voluntarily seek the highest level of professional competency — not in pursuit of economic gain, but out of a sense of professional obligation to those being served.

Fewer than 1 in 10 professionals in our industry hold any voluntary certification.

Many in our industry complain that there are too many credentials. This is another area in which we show our fragmentation. Complaining that the alphabet soup has too many letters is a poor excuse for not eating your soup. At issue in our industry is not the quantity of credentials but the quality.

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*Sean Walters is executive director and chief executive of the Investment Management Consultants Association.*

# Firm grows by focusing on needs of execs

*Scott Oeth says when advisers specialize, their advice improves*

**By Liz Skinner**

ADVISER'S CONSULTANT
NICHE PRACTICE

Scott Oeth could have taken his advisory career in several different directions nearly a decade ago when he decided he wanted to develop a niche practice.

Formerly a competitive volleyball player, Mr. Oeth had a nice collection of blockers and hitters on his client roster. He also had a cluster of physicians whom he was advising.

But when he thought about the type of client he was offering the most value to, he realized it was the corporate executives he was giving advice to, primarily about deferred compensation plans and stock options.

Today, executives make up most of his client list at Cahill Financial Advisors, and that's the area of his business showing the fastest growth.

"It's appealing to be the specialist in an area," said Mr. Oeth, a principal at the Minneapolis-based firm. "When you get a referral, it's almost a prescriptive referral — where a client says to someone in a similar situation, 'You have to talk to my adviser about this.'"

When advisers specialize, the quality of the advice they provide improves, Mr. Oeth said. He works with many executives at Target Corp. and knows the specific details of the company's stock options, the deferred comp plans and the investments offered in their retirement plan.

Scott Oeth

**KNOWLEDGE BASE**

"Having a solid understanding of the tools we have to work with can really help in crafting the advice specific to that client," he said.

Gaining the knowledge needed to serve a particular group of clients is crucial to becoming a specialty adviser.

Mr. Oeth was already teaching a certified financial planner course that covered much of the information advisers need to serve executives, but he added to his own education a specialized master's degree in financial planning to develop even more skills.

"Make sure you are competent and can deliver what you promise," Mr. Oeth recommended to other advisers seeking to create a niche. "Don't sell something that you can't really back up."

He also built up the relationship he had with an executive at Target, also based in Minneapolis, and created a study group with other professionals and centers of influence who work on different issues for executives. This group of attorneys, trust officers, private bankers and others gather for lunch monthly to discuss specific planning issues of executives.

He also became even more involved with financial planning organizations, which resulted in other advisers recognizing his skills and recommending him when they couldn't meet the needs of certain clients or prospects, Mr. Oeth said.

**'IDEAL CLIENT'**

One of the challenges of focusing on a specialty is having to sometimes turn away clients who aren't part of a firm's "ideal client" demographic.

Practically speaking, such rejections might not be feasible in the earliest years of growing a business, Mr. Oeth said.

And all happy clients, of course, are good "advertising," he said.

Another challenge is staying focused on a particular specialty when other niches start to present themselves.

"You need a balance between looking around the corner to see what's coming in the industry and looking for opportunities, but not abandoning what you've already put time and money into," he said.

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## Tip sheet

• Identify a group with specific needs, such as those requiring technical expertise or certain financial products to serve them well.

• Consider forming a study group with other professionals who target the same clients.

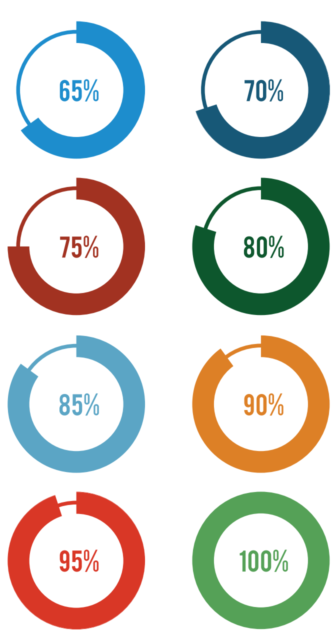
• Networking is crucial when you market through centers of influence; take larger roles in industry groups so you become known as an expert in a field of study.

• If targeting clients directly, use videos, podcasts and other digital media to build a brand that identifies you as an expert at helping this type of client.

• Pursue certifications or other education that pertains to the area of expertise you're establishing; make sure you are technically competent to provide the advice and deliver what you promise.

• Give yourself time to grow this area of business; don't get distracted by other specialties.








# Merrill's Thiel urges fiduciary collaboration

**By Mason Braswell**

At least one major industry player is taking a more welcoming stance toward working with the Labor Department as it seeks to create a rule that would hold brokers to a fiduciary standard when dealing with retirement plans.

John Thiel

Speaking last Wednesday at a conference for the Securities Industry and Financial Markets Association, an industry trade group that has been a vocal opponent of the DOL's fiduciary efforts, the head of Bank of America Merrill Lynch, John Thiel, advocated for working more collaboratively with the regulator on a rule.

"Since 2010, we have supported the notion of a consistent and higher standard for every professional that deals with the American investor and those that deal with retirement plans," he told the roughly 200 industry executives gathered in Chicago for the conference. "As an organization, we have provided input to policymakers in Washington; we believe we were heard and we will have an additional opportunity to comment once the rule is open for comment."

The view ran contrary to that of many brokerage and insurance trade groups, including SIFMA, the Financial Services Institute Inc. and the Insured Retirement Institute. They have strongly opposed a rule proposal from the DOL out of the concern that it may limit compensation for brokers who sell individual retirement accounts and possibly reduce the availability of advice for middle-income clients.

SIFMA also had argued that the Securities and Exchange Commission, not the DOL, should be responsible for issuing any uniform fiduciary standard.

"The industry has a responsibility not just to respond, but also to lead, even if it means challenging our regulators, on a popular-sounding but ultimately counterproductive notion," SIFMA president Kenneth Bentsen said in his opening remarks at the conference.

A spokeswoman for SIFMA, Katrina Covalli, declined to comment on Mr. Thiel's speech.

Although Mr. Thiel did not reference the Labor Department by name, his comments referred to a rule proposal that will soon be open to comments (as the DOL's will).

**'THE RIGHT THING'**

Mr. Thiel's comments took a more flexible tone toward that proposal, implying he and Merrill Lynch have been working constructively on it with the DOL.

"As an industry we should work in a constructive and collaborative manner that's in the best interest of clients," he said. "It's obviously the right thing to do."

It could put pressure on other firms to take a similar approach, as Merrill Lynch remains one of the largest firms under SIFMA's umbrella with more than 14,000 advisers and $2 trillion in assets.

Asked after his speech why he didn't use the word "fiduciary" specifically, Mr. Thiel said "best interest" was easier for investors to understand.

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# Subscription the wrong prescription for planners?

*LearnVest deal raises questions on viability of a payment model*

**By Darla Mercado**

Northwestern Mutual's impending acquisition of LearnVest, an online advice platform that also provides one-on-one financial counseling through advisers, has raised a discussion about the long-term viability of low-cost, subscription pay models to serve middle-class investors.

Northwestern Mutual announced March 25 plans to acquire LearnVest, which was founded by its chief executive, Alexa von Tobel, in 2009. It offers planning to the masses by charging a $299 upfront fee plus a $19 monthly subscription.

With the acquisition, Northwestern Mutual will gain 1.5 million users of LearnVest's services, 10,000 premium clients, and 25,000 clients from LearnVest at Work, a workplace financial wellness program.

The deal also places a spotlight on the subscription-based fee model as a way to pay for planning services. Whether firms and advisers can make a successful go at that, however, will depend on the execution.

Using any subscription model for financial planning has its obstacles because prospective clients expect a great deal of hand-holding — not just budgeting and recommendations for the immediate term — to go along with their financial planning. Those clients often find it unappealing to pay monthly for services they use once in a while.

"I see the value in creating a customized and individual financial plan, but the issue comes with $19 per month: How much value is there?" asked Matthew Eschmann, an analyst at Corporate Insight, outlining what customers may think. "There's great advice out there for free. Reddit has a financial forum where you can ask questions."

**DUELING PRIORITIES**

The problem is that while budget-conscious clients demand a greater degree of service for their fees — even if those fees are low — advisers and planners still need to remain solvent.

"How can you provide unlimited access to a certified financial planner by phone or email?" asked Sheryl Garrett, founder of the Gar-

**Continued on Page 25**

**Sheryl Garrett:** One email can cost an hour's time for the adviser.

# Target date managers lack skin in game

**By Darla Mercado**

Money continued to pour into target date funds in 2014, but very few of those dollars came from the managers who oversee them.

Last year, nearly $50 billion in net new flows went into target date funds, reflecting an 8% organic growth rate, according to a recent report from Morningstar Inc. The funds, long viewed as the go-to tool for set-it-and-forget-it 401(k) investors, have played a large role in shipping assets to the fund companies themselves, accounting for more than 30% of the net new inflows to their respective fund firms last year.

But success aside, the vast majority of target date fund managers won't put their money where their mouth is. Out of 57 target date mutual fund series analyzed by Morningstar, 32 have zero personal investment from their fund managers.

> "IT SHOULD BE good for you if you think it's good for others."
>
> **Jim Lauder**
> Chief executive
> Global Index Advisors

"It's pretty dismal, actually," said Janet Yang, director of multi-asset-class research at Morningstar. Managers investing in their own funds "is one of those things that's intuitively appreciated."

**SOME FIRMS BAR PRACTICE**

In 2014, just two managers invested more than $1 million individually in their own target date funds. Those managers were Bradley Vogt of American Funds and John Cunniff of TIAA-CREF.

But Ms. Yang noted that sometimes there were circumstances barring fund managers from investing in their own funds. Managers at T. Rowe Price and BlackRock, for instance, invest in the collective investment trust versions of their target date funds. Nevertheless, "the fact that more than half of the fund

**Continued on Page 25**

# Liquidity restrictions in play

*Money market fund managers will have to deal with the concept of gates*

By Trevor Hunnicutt

"Conversations ... highlighted significant concern regarding funds that are subject to gates."

Tom Callahan and Rich Hoerner
Executives, BlackRock

BLOOMBERG

Some investors demand nothing less than unfettered access to their cash at a stable price. To deliver that, asset managers are increasingly going to be offering them money market funds that invest almost exclusively in cash and very low-interest government-secured debt.

Others, looking for money market funds with potentially richer yields, are going to have to get to know a concept more familiar to hedge fund clients: gates.

BlackRock Inc., the third-largest U.S. money market fund provider, announced last Monday in a letter to clients some of its plans for its $218 billion in largely institutional funds. Among the changes affecting mom-and-pop investors: Some of the firm's estimated $22 billion in retail funds invested in corporate debt will convert to government-investing funds. The firm has not said which funds will transition.

The move, which the firm first announced earlier this year, follows similar decisions by other fund companies. Fidelity Investments, for example, is converting three of its prime funds, including the $110 billion Fidelity Cash Reserves (FDRXX).

The changes mean that those converted funds will now primarily invest in short-term government debt, which is considered virtually risk-free. But those securities could also depress the already thin yields the funds pay out to investors.

The fund managers are attempting to protect the stable $1 per share quoted to investors, as well as to tamp down fears of managers' preventing withdrawals in times of market stress. Government-focused funds are exempt from Securities and Exchange Commission requirements due to go into effect next year that would force them to let their share prices fluctuate and allow them to impose liquidity restrictions.

### SHIFT TO VARIABLE RATE

But not all retail funds are going to drop municipal securities and corporate debt in order to protect their stable net asset values. BlackRock, for instance, said some of its money market funds would maintain a focus on municipal securities. But those funds will focus on a type of debt, variable-rate demand notes, that pays off in an extremely short amount of time, within a week. BlackRock said those securities would "minimize" volatility and "significantly reduce the probability of the implementation of gates and fees."

Legg Mason Inc. affiliate Western Asset Management, announcing its planned changes last Tuesday, said it will "adopt policies to impose liquidity fees, as well as provide for redemption gates" in its retail funds.

More such changes are expected before the October 2016 deadline to comply with the new rules.

When the rules go into effect, nongovernment money market fund managers can impose fees on redemptions in times of market stress. They can also choose to restrict redemptions, known as a gate, in certain cases.

By designating the funds "retail," managers can sidestep the requirement to let the fund's net asset value float from $1 per share, but at the cost of demonstrating that all the fund's investors are individuals. Institutional funds will be expected to let their share prices fluctuate above or below $1, and also may allow liquidity restrictions.

Broker-dealers have pushed back on the idea of gates, according to the BlackRock letter's authors, executives Tom Callahan and Rich Hoerner.

"Conversations with our retail distribution partners highlighted significant concern regarding funds that are subject to gates and fees for retail clients," they wrote. "Feedback from many of our retail partners currently using various BlackRock money funds for daily cash sweeps indicates it is uncertain that anything other than [constant-value] government funds will be offered for sweep accounts. The feedback stems from the cost of modifying systems to operate sweeps and the associated operational risk from implementing gates and fees."

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# Preparing for rise in fed funds rate


Now that the best parts of the bond market rally are behind us, it's time for advisers to start considering how to position clients for a likely increase in the federal funds rate later this year.

I think the Federal Reserve is probably going to do something in September. It could still move its first rate increase into early 2016, but Fed officials seem anxious to begin raising rates because they perceive that as the U.S. economy begins to accelerate, the probability of creating asset bubbles is increasing.

We've taken a historical look at periods following Fed rate increases. The best-performing fixed-income asset class is floating-rate securities, typically led by leveraged loans.

The likelihood that we're going to have some sort of adverse credit event in the next couple of years is very low. The Fed will begin raising rates because the U.S. economy is getting stronger. Strong economies are not associated with increasing default rates and are generally associated with tightening credit spreads. That's why we see leveraged loans, or bank loans, as one of the most attractive asset classes.

### LOOKING TO THE FUTURE

As the Fed begins to raise rates, the yield curve should flatten more. As the curve flattens, long-duration securities don't have as much room for an increase in rates as short-duration securities do. So that barbelling of the curve will allow fixed-income investors to participate in the increase in yield on short-term rates, but also will insulate them from the risk of another downward spike in interest rates.

Advisers must develop a new, sustainable, long-term strategy to generate yield for their clients. We believe the solution lies beyond the Barclays U.S. Aggregate Bond Index.

Since its creation in 1986, the Barclays Agg has become the most widely used proxy for the U.S. bond market, with over $2 trillion in fixed-income assets managed to it. The Barclays Agg once was a useful proxy for the universe of fixed-income assets, which primarily consisted of U.S. Treasuries, agency bonds, agency mortgage-backed securities and investment-grade corporate bonds — all of which met the inclusion criteria. However, the fixed-income universe has evolved over the past 30 years with the growth of such sectors as asset-backed securities and municipal bonds.

The historical average yield of the Barclays Agg is 7.1%. Last Monday, the average index yield was approximately 2.1%. With each index sector yielding less than 4%, investors are facing a scarcity of yield across the fixed-income landscape.

Extending duration or increasing credit risk to meet yield objectives may prove successful in the near term, but utilizing these investment shortcuts carries long-term risks.

### GROWING CHASM

The traditional core fixed-income strategy is overly confined by a benchmark that no longer accurately reflects the opportunities that exist in the fixed-income landscape today. It does not allow for portfolios shifting toward more attractive opportunities that emerge from changing markets, and perhaps most important, it fails to incorporate active duration management, which could result in real losses.

As the chasm between investors' income targets and obtainable market yields deepens, it is apparent that the traditional view of core fixed-income management requires innovation.

Over the next several years, we believe global central bank easing will continue to support a benign credit environment, but we are intensely focused on how the current accommodative conditions are likely masking a comprehensive, marketwide underappreciation of investment risks.

*Scott Minerd is chairman of Guggenheim Investments and global chief investment officer at Guggenheim Partners.*

# QE Too: European equity a hit with ETF buyers

By Jeff Benjamin

The launch of the eurozone's quantitative easing program has not been lost on investors who are now pouring money into the European equity markets, as measured by record inflows in March.

TrimTabs Investment Research calculated a record $7.8 billion worth of net inflows into Europe-focused equity exchange-traded funds last month, even though some have suffered from the performance drag caused by a surging U.S. dollar.

"The massive buying shows absolutely no sign of slowing," said David Santschi, TrimTabs chief executive.

"Europe equity ETFs already issued $950 million on the first two days of April," he added.

The March inflows into the category beat the record set in February of $4.4 billion. And, according to TrimTabs, the category hasn't posted a daily net outflow since Feb. 3.

"You could almost call it front-running quantitative easing," said Scott Colyer, chief executive of Advisors Asset Management.

"The eurozone has pulled out all stops to support those economies, and investors have been moving in because they know what QE has done for the U.S., U.K. and Japanese stock markets," he added. "But it is starting to look like a crowded trade, and I would suggest if you don't own it now you might want to wait a bit for a better entry point."

**FORWARD MARCH**

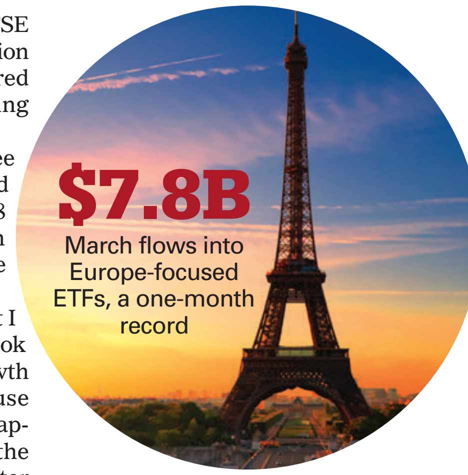
Evidence of the kind of confidence investors have in quantitative easing is found in the $930 million in March inflows for the $9.63 billion iShares MSCI EMU (EZU). This is an ETF that took in $730 million during January and February, combined.

The $18.73 billion Vanguard FTSE Europe ETF (VGK) had $550 million worth of March inflows, compared with a total of $740 million during the two previous months.

The $17.3 billion Wisdom Tree Europe Hedged Equity Fund (HEDJ) had March inflows of $4.8 billion, compared with $5.3 billion during the first two months of the year combined.

"These are abnormal flows, but I think investors will continue to look to the eurozone for signs of growth from quantitative easing because they've already seen what can happen with quantitative easing in the U.S.," said Todd Rosenbluth, director of mutual fund and ETF research at S&P Capital IQ.

"U.S. investors have been mostly underexposed to European equities because the U.S. has been a much stronger market," he said. "It could be a bit of a catch-up for investors, and the trend is your friend, until it's not."




Nick Kalivas, senior equity product strategist at Invesco PowerShares, said there are a lot of forces working in favor of European stocks, but that doesn't mean the rush in won't lead to some kind of sudden correction.

"Certainly, people are aware of what has happened with U.S. stocks, and they now see the QE in Europe as a replay of that," he said.

Factoring in the weaker euro, which benefits European exporters, makes the trade even more attractive, Mr. Kalivas explained.

"It generally takes about a year for a change in currency to filter into and completely work through the stock market," he said. "Since the euro has fallen so sharply, it should benefit investors through 2016."

And, relative to U.S. equities, he said, European stocks still look cheap.

But, he noted: "I think the investor has to be very conscious of the risks of a correction in the near term, and that makes me a little uncomfortable."

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# Advice for investing: Gather ye rosebuds before May comes


Are market moves purely random? It can be challenging to provide explanations for market price movements with so many factors driving one group of investors to buy and another to sell. Many find it easier just to accept dynamic moves as unpredictable. However, history contains many examples of human behavior influencing patterns in financial markets and sometimes creating investment opportunities.

Seasonal market trends may be one of the most cited examples. More specifically, the U.S. equity market has historically outperformed, on average, during the six-month period from Nov. 1 through April 30, compared with the other six months of the year.

Other well-known seasonal anomalies, such as the "Monday effect," the "Friday effect," the "turn of the month effect," the "holiday effect" and the "January effect" often are mentioned, but these tend to lose strength when submitted to more rigorous examination.

However, the "sell in May" anomaly, as the November through April seasonality effect is sometimes called, has weathered a fair amount of academic scrutiny and appears to happen often. The historical pattern of springtime sell-offs is well-documented and can even be traced as far back in Britain as 1694.

**SUBSTANTIAL DIFFERENCE**

The first comprehensive study on the topic, from Sven Bouman and Ben Jacobsen (2002), drew on extensive data to demonstrate the substantial difference between returns from May to October and those from November to April. Concluding that "the economic significance of this particular anomaly is considerable," the authors went on to compare "a simple trading strategy based on the saying" with a buy-and-hold portfolio using past data in multiple countries. In many of these countries, the seasonality-inspired portfolio compared favorably.

The authors noted that the scale of the sell-in-May effect is highly correlated to the length of a particular country's average summer vacation. While they suggest that this trend relates to a decrease in risk aversion during one's vacation, others have assumed that the risk aversion has more to do with so-called seasonal affective disorder, or that investor behavior is directly linked to temperature changes.

Factors with more narrow calendar-related effects may contribute to the overall seasonal effect. For example, commentators sometimes speculate that changes in liquidity brought on by an influx of capital at year's end contribute to the January effect.

Another suggestion is that year-end bonuses and commissions may be distributed within a few months of Dec. 31. Others point to year-end earnings announcements.

While definitive causes remain elusive, the persistence of stock market seasonality seems apparent in the overall November through April level. A follow-up to the Bouman-Jacobsen research, conducted by Sandro C. Andrade, Vidhi Chhaochharia and Michael E. Fuerst in 2012, again found persistent benefits from following "sell in May and go away" as a market-timing strategy. The authors found "an economically large and statistically significant sell-in-May effect in strategies exploiting the value, size, credit risk, foreign-exchange carry trade and volatility risk premiums."

The seasonality effect suggests investor actions may affect market moves that do not appear to be purely random. Tracking seasonal market factors may be one approach to taking advantage of that over time.

*Isaac Braley is president of BTS Asset Management.*

# Unlock HSAs' full potential with two changes


Few topics elicit a greater response from financial advisers than health savings accounts. This interest is warranted as rising health care premiums and the consumer-directed trend in health insurance have fueled meaningful growth in HSA popularity. Advisers are now seeking ways to offer investment solutions and allocation advice for HSA assets.

Most people who fund HSAs place their contributions into a money market fund, and then use a debit card to pay for uncovered medical expenses. I recommend two changes to this strategy:

1. Instead of placing your HSA contributions into a money market account, invest the money into an asset class suitable for long-term growth.
2. Refrain from using the money on current health-care needs. Treat the account as you would your other retirement savings vehicles.

**CUSTODIANS**

One key question that follows is: How do I, as an adviser, manage this asset? The industry is making progress with this issue, but still has a way to go. We must recognize that a health savings account requires an HSA custodian. Most custodians are banks, financial services companies or health benefit administrators. Since most individuals obtain their health insurance and corresponding HSA through their employer, with the employer often making a contribution, the custodian is usually connected with the employer's health insurance provider. Most custodians, however, do provide investment choices by establishing a relationship with various investment firms. Some will offer a limited menu of mutual funds, but some do provide a full-service brokerage account.


**RELATIONSHIPS**

For example, Charles Schwab & Co. Inc., Fidelity Investments and TD Ameritrade all have relationships with HSA custodians. This at least provides an adviser the opportunity to engage clients in a conversation about prudent ways to allocate HSA assets, and may even provide a means to link the account to the adviser's book of business.

The rollover/transfer market also creates opportunities. HSA assets, unlike 401(k) assets, always are available for transfer. Clients can use an independent custodian who offers the aforementioned investment accounts. A quick Internet search will provide a list of custodians and corresponding administrative fees.

**MONEY MARKETS**

Perhaps the good news is that individuals who invested their HSA assets earned 12.5% over the last three years. The more challenging statistic is that 87% of HSA assets are in money market accounts. For those who use the account as a liquid source of health-care reimbursements, this makes sense. The need, however, is to educate clients about health-care expenditures during retirement and the benefit of creating tax-free sources of income to fund these costs. To illustrate this concept, consider a 50-year-old married couple who:

- Contribute the maximum $6,650 to an HSA family account.
- Contribute the additional $1,000 per year starting at age 55.
- Refrain from making any distributions.
- Invest the money and earn 8%.

For simplicity, I will assume the contribution limit remains at $6,650. The reality is that the limit will be raised to adjust for inflation, allowing even greater contributions. At age 65, the HSA account would be valued at $210,652.

As you speak with your clients, find out who is using a high-deductible health insurance plan with a health savings account. Help them utilize the full potential of these plans as part of your overall comprehensive retirement income plan.

*Peter Stahl is the founder of Bedrock Business Results, which provides training to financial advisers and their clients on the convergence of health care and financial planning.*

# Markets cool to companies reinvesting their cash

**Bloomberg News**

If you're an American chief executive with a couple million dollars to blow, you may want to think twice before using it to expand plants or add equipment.

That's the message from equity markets, where shares of companies using the biggest portion of their cash on capital expenditures in 2014 trailed those that spent more on dividends and buybacks, according to data compiled by Barclays Plc. While the underperformance didn't keep corporate investment from hitting a record last year, the rate of growth in repurchases was higher.

The research is the latest to depict the U.S. stock market as being addicted to cash inducements provided by companies to investors at the expense of businesses and employees.

Barclays' chief equity strategist, Jonathan Glionna, said that while the data should dispel concern that companies have abandoned projects that boost profits and stoke economic growth, it shows the market prefers other uses for money.

"There's plenty of [capital expenditure] spending and companies that spend more have generally been underperforming," Mr. Glionna said via phone on April 2.

It's a problem if investors are more apt to reward spending with the least value to the economy, said Marshall Front, who manages $800 million at Front Barnett Associates. Over longer periods they're better off rewarding capital spending, which boosts revenue down the supply chain and gets more people working, he said.

ISTOCK

## 'VIRTUOUS CYCLE'

"You create a self-fulfilling virtuous cycle of constructing buildings, hiring people and creating more things, whereas very little in the productivity cycle comes out of buybacks," Mr. Front said. "There's a limit to how far you can go with this."

S&P 500 companies hold $1.6 trillion in cash and marketable securities, data compiled by Bloomberg show. They've been increasing capital expenditures every year since 2009 and spent $730 billion in 2014, the highest ever, according to Barclays, with companies like Chevron Corp. and AT&T Inc. investing more than $20 billion in the last year.

At the same time, companies in the benchmark index spent a sum equal to 95% of their earnings on repurchases and dividends in 2014, data compiled by S&P and Bloomberg show. That includes $553 billion of buybacks in 2014 and a total $1 trillion in the past two years, the biggest two-year sum in history, according to data going back to 1998. The S&P 500 has added 1.1% this year, compared with a 2.9% advance in an S&P index tracking the top 100 stocks with the highest buyback ratio.

## JUST PLAIN UNJUST

"It may seem unjust that the equities of companies that make long-term capital investments in their businesses perform worse than the equities of companies that buy back their shares," Mr. Glionna wrote in the report. "We do not see this trend changing."

Instead of creating a basket of stocks representing each group of companies — those spending the most on capital expenditures, buybacks or dividends — Mr. Glionna's team created indexes measuring the difference in return between the biggest and smallest spenders in each respective category.

A gauge measuring the gap in returns between companies with highest and lowest capital expenditures has fallen 8% since 2010, compared with a 2% increase in a gauge tracking companies doing stock buybacks. High- dividend spenders did even better.

"If you do it on a spread basis, you isolate the impact of [capital expenditures]," Mr. Glionna said. "The reason we don't just use a basket of stocks with the most [capital expenditures] is because it will be too influenced by the direction of the market — the basket might be going up just because the market's going up."

Buyback and dividend shares outperformed even though investors surveyed by Mr. Glionna claimed they preferred other uses. The survey showed 35% of respondents said corporations should deploy excess cash through capital expenditures, compared with 25% for dividends and 17% for buybacks.

# In dismal quarter, some sectors could swim against tide

*Energy sector to weigh down S&P average in 1Q*

**By Jeff Benjamin**

In the wake of the disappointing jobs report on April 3, it is time for financial advisers to start bracing for what could be the worst quarterly earnings season in six years.

The consensus estimate is for S&P 500 Index earnings in the first quarter to decline 3% from a year ago, a grim reality that is being weighed down by an energy sector that is expected to show a 63.4% decline.

But the good news is, a few of the 10 index subcategories should come out of the quarter in decent shape.

The financial sector is expected to show an 11% increase over the same quarter last year, health care is supposed to be up 9%, and consumer discretionary should be up 7.3%, according to the latest data from S&P Capital IQ.

> "IT'S REALLY all about the drop in crude oil prices, which were almost double where they are today a year ago."
>
> **Todd Rosenbluth**
> Director
> S&P Capital IQ

### ENERGY DRAG

"The drag from energy is so significant that it's helping to move the overall index earnings into negative territory," said Todd Rosenbluth, S&P Capital IQ's director of mutual fund and ETF research.

"It's really all about the drop in crude oil prices, which were almost double where they are today a year ago," he added. "So it's not going to be a good picture for earnings in general."

As usual, earnings season officially kicked off last Wednesday when Alcoa Inc. (AA) reported after the stock market closed. But it will take until the middle of June before every company in the index has reported.

With that in mind, there are a few ways to get some easy and diversified exposure to some of the winning categories.

Specifically looking at the financial sector, Mr. Rosenbluth singles out John Hancock Regional Bank Fund (FRBAX) and Davis Financial Fund (RPFGX).

For health care, which continues to benefit from more business related to Obamacare, he recommends BlackRock Health Sciences Opportunities Fund (SHSAX) and Prudential Health Sciences Fund (PHLAX).

For more diversified exposure to the healthiest sectors, Mr. Rosenbluth highlights Invesco Comstock Fund (ACSTX) and John Hancock Disciplined Value Fund (JVLAX), which have significant exposure to large-cap health care, financial and consumer discretionary stocks.

### DIVERSIFIED FUNDS

"The more diversified funds are the most appropriate, because you could see earnings turn from one sector to another from quarter to quarter," Mr. Rosenbluth said.

Meanwhile, there is a school of thought that the earnings estimates might be slightly off the mark, and not as bad as projected, according to Douglas Coté, chief investment strategist at Voya Financial Inc.

He cites consensus analysts' estimates from October that showed, for example, energy-sector earnings improving by 3% in the first quarter.

The financial sector, at the same time, was expected to generate a whopping 19% year-over-year earnings increase.

"Everything looked too optimistic before, and now it's looking way too pessimistic," Mr. Coté said. "We've gone from extreme exuberance to extreme pessimism, and what I'm thinking is that the S&P might actually eke out a positive gain for the quarter once all companies have reported."

Part of what makes Mr. Coté so confident is that the estimates have been missing on the low side for most of the bull market run.

"We know energy will be down, but the overall consensus, having gone from very positive to very negative, is an extreme swing that's overdone," he said. "How many times do earnings have to beat the estimates before we stop relying on the estimates?"

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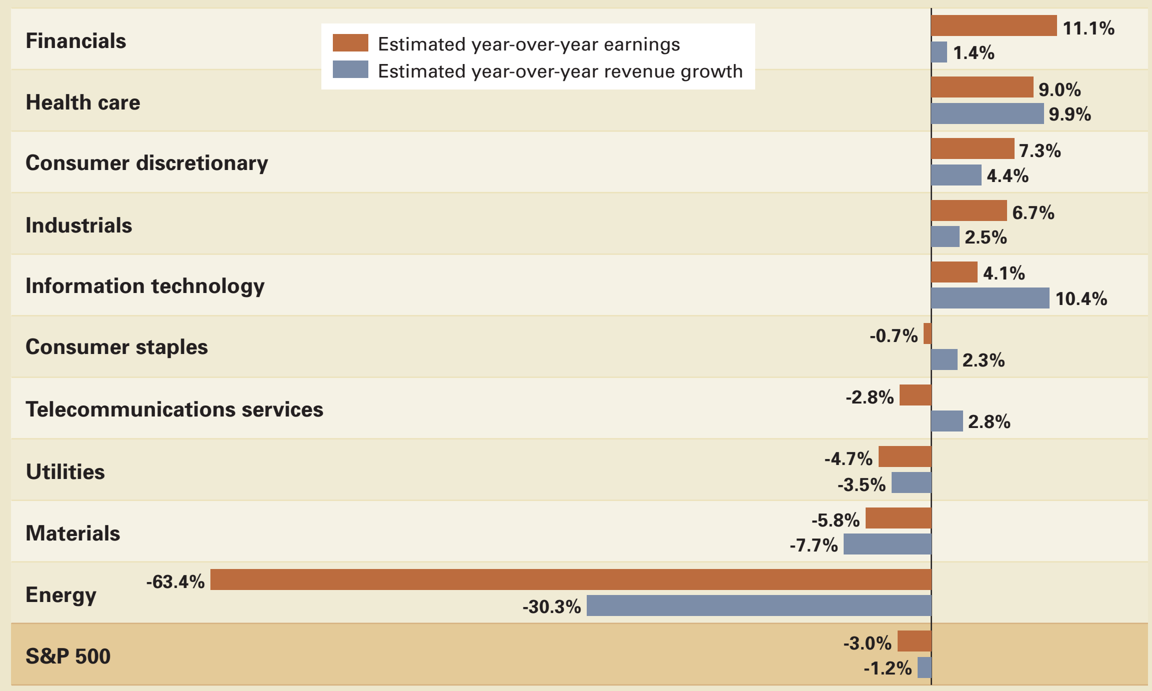
## Spot the outlier

Energy sector earnings sink S&P 500 Index in first quarter




**Source:** S&P Captial IQ

GERARDO TABONES



# Focus takes stake in firm

*Bucks trend, invests in $600M indie advisory*

**By Trevor Hunnicutt**

Focus Financial Partners, the deep-pocketed investor in financial-advisory businesses, said last Monday it has taken a stake in a 45-year-old firm managing $600 million in assets.

Under Focus' umbrella, the Savannah, Ga.-based Fiduciary Group plans to add to its ranks of financial advisers and extend its reach in the Southeast, according to chief executive Malcolm Butler.

"I'm advising my clients all the time about estate planning and, in a sense, this is estate planning for the business," said Mr. Butler, who is 57. "We have set a structure in place that, for the lifetime that I'm with the firm, we are only going to get stronger. And then, at such a point that I or one of the other principals is no longer working here, we have the structure in place to bring in the next generation of advisers."

The deal took effect April 1. Terms were not disclosed.

Focus, founded in 2006, has been an aggressive investor in wealth management firms. Its "partner" firms, in which it takes an ownership stake, now total more than 30, according to a Focus publicist.

In addition to working with wealthy individual clients, Fiduciary Group provides financial advice to company-sponsored retirement plans.

The firm employs nine people and has three principal owners, including Mr. Butler. He joined the firm in 1980 and took over as CEO in 1998. His father, Lee Butler, founded the firm in 1970, according to the firm's website — long before the independent-affiliation business model was fashionable.

### M&A SLOWS

Focus' deal comes as large investors in the independent-adviser market have slowed their pace of acquisitions. Overall, the number of those deals was flat last year, representing $47.4 billion in AUM, according to a study released late last month by the Charles Schwab & Co. unit that serves independent advisers.

The custodian tracked 54 publicly announced deals in 2014, the same as in 2013 and only slightly higher than the nine-year average.

The report found that "aggregators" such as Focus slowed their pace of acquisitions. Those investors, which Schwab calls "strategic acquiring firms," represented only 38% of deals last year. That figure is down from over half in 2012.

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# With contrarian bet, Gross regains footing

Bloomberg News

After a shaky first five months, Bill Gross is regaining his footing at Janus Capital Group Inc., helped by a contrarian bet that the dollar's rally won't continue.

Mr. Gross' $1.5 billion Janus Global Unconstrained Bond Fund has returned about 2.4% in the past month as Treasuries rallied and the dollar gave up gains against the euro. The rebound reversed losses in the first five months and leaves Mr. Gross beating 68% of peers since he took over on Oct. 6, including the comparable fund at Pacific Investment Management Co., the firm that ousted him in September.


FIGGE PHOTOGRAPHY

**Bill Gross:** Now beating 68% of peers since he took over at Janus.

Mr. Gross said in an interview that he's been betting for several months that the dollar would stop rising and the gap between U.S. and European interest rates would narrow, a trade that hurt performance until markets turned a few weeks ago. His call contrasts with remarks by money managers such as Jeffrey Gundlach, who warned investors not to bet against the dollar. Laurence D. Fink, who runs BlackRock Inc., the world's largest money manager, said last Monday that the dollar's strength risks undermining business confidence in the U.S.

"It's not the trade of the century or the trade of the decade but I think it's the trade of the year," Mr. Gross said. "Patience in the last two to three months has been rewarded."

Janus Unconstrained has gained 1.1% since Mr. Gross took over, compared with a return of less than 0.1% for the $9.8 billion Pimco Unconstrained Bond Fund, run by Mr. Gross' successor Daniel Ivascyn, Marc Seidner and Mohsen Fahmi. In the past month, Mr. Gross has beaten 99% of comparable funds, according to Morningstar Inc.

**'OBSESSIVE GUY'**

For most investors, one month or even six months is too short a period to evaluate a fund. Institutions such as pension funds often require three- or five-year track records before they invest in a new manager.

Still, for Mr. Gross, the rebound is important after his fund in February suffered its first client withdrawals since he took over. Mr. Gross has said he's investing to "show clients and the world" that he can still win after leaving Pimco, which he built into a $2 trillion money manager at its peak. Mr. Gross, who is 70, said last month he has "two, three, four years" to prove himself at Janus.

"I'm sort of an obsessive guy," Mr. Gross said. "I have a happy night if I'm doing better, and a not so happy night if I'm not doing better. That's just being competitive. That's like somebody in the NBA being traded from the Miami Heat to Cleveland Cavaliers — next time you get on the court, you want to whip the pants off of them."

Mr. Gross, who characterized himself as a traditionally pessimistic "bond guy" in the interview, said he had been betting on U.S. Treasuries against German bunds, and selling credit-default swaps tied to the debt of countries that benefit from a weak U.S. dollar, including Mexico, China and Colombia, he said.

The dollar has declined 3% against the euro since March 13 and Treasuries have gained 1.3%. Treasuries surged April 3 after a report showed the economy added the fewest jobs since December 2013.

The fund struggled initially after Mr. Gross took over, declining 1.3% in the first five months through March 6. It trailed its benchmark in the fourth quarter last year primarily because it had plowed about 5% of net assets into debt issued by U.S., Russian and Brazilian energy companies. Those bonds and emerging-markets sovereign debt that Mr. Gross insured were all hit by the 42% collapse in crude prices in the period.


ISTOCK

# IRS sends taxpayers message

Bloomberg News

If it feels like you're seeing an inordinate number of stories about criminal tax prosecutions lately, expect to read even more soon. IRS prosecutions spike in April, possibly as a not-so-gentle reminder during filing season that there can be a big price to pay for tax evasion and tax fraud.

A data analysis by the Transactional Records Access Clearinghouse at Syracuse University shows that in April the number of criminal prosecutions coming from IRS investigations is consistently significantly higher than it is in January.

The director of the TRAC Research Center, Susan Long, said the pattern isn't coincidence. It's also not because the IRS just found juicy cases to refer to prosecutors from the current tax season — the lead time is way longer than that.

"Back in 1973, we got IRS manuals, and they actually talked about coordinating [prosecutions] during tax season to make people think about their responsibility under the tax law," Ms. Long said.

The IRS did not respond to a request for comment.

**CRIMINAL CHARGES**

When prosecutors decide to pursue a case based on an IRS investigation, they can levy a number of criminal charges in one case: money laundering, mail fraud, bank fraud and so on. But they have to choose one violation from the laundry list as the "lead charge" in their case.

"Fraud and false statements" is the most common choice. Next up: "conspiracy to defraud the Government" claims. Those cases are up 37% over the past year, and over the past five years they're up almost tenfold.

Feeling worried now about cutting any corners with your taxes? Messing with the tax man is never a good idea, but fewer than 2% of Americans are investigated for tax fraud, according to Nolo.com, a publisher of legal self-help books. If they are, the odds of getting hit with a civil fine or criminal charge is around 20%.

FIDUCIARY CORNER

Blaine F. Aikin

# Fiduciary foes spitting in the wind

*New regulations aside, megatrends will demand that advisers align themselves with clients*

Worried that new fiduciary rules from the Department of Labor and the Securities and Exchange Commission will disrupt your business? Why?

All that the new regulations would do is codify what the megatrends of capitalism, technology and social values have already started. If your business is built on the ability to provide personalized advice without adherence to fiduciary obligations, then your model is outdated.

Even if the new rules don't get implemented, or are watered down to the point of ineffectiveness through the political or legal maneuvering of fiduciary foes, the era of advice without fiduciary accountability is rapidly drawing to a close, and the end will come with or without new regulations.

In a guest editorial in the May/June 2014 edition of the *Financial Analysts Journal*, "A New Era of Fiduciary Capitalism: Let's Hope So," the president and chief executive of the CFA Institute, John Rogers, explained, "In fiduciary capitalism, the dominant players in capital formation are institutional asset owners; these investors are legally bound to a duty of care and loyalty and must place the needs of their beneficiaries above all other considerations. The main players in this group are pension funds, endowments, foundations and sovereign wealth funds."

Mr. Rogers cited three forces at work in this new capitalism. First is the huge and growing size of institutional investing power, with the top 1,000 institutional fiduciaries worldwide holding more than half ($25 trillion) of global equity market value. This represents a shift in power from sell-side financial product providers to buy-side institutions.

For archived columns, go to InvestmentNews.com/fiduciarycorner

Second: technology. "For decades, brokers and investment bankers enjoyed an asymmetric information advantage over the institutional asset owners they did business with," Mr. Rogers said. "That information gap is mostly gone now."

Third: agendas. "To many fiduciaries, things like market outperformance, an information 'edge,' trading, flow and league tables are not particularly important," Mr. Rogers said. "The only thing that really matters to these investors is delivering the returns that are uniquely required by their ultimate beneficiaries." With ultra-long-term time horizons and high cost and conflict sensitivity, these behemoth investors have the clout to force fiduciary-friendly conduct from their sell-side counterparts.

Another must-read guide to understanding the new investment paradigm is a compelling 80-page report from KPMG, "Investing in the Future." It is packed with insights about four megatrends that will reshape the investment industry over the next 15 years. The four trends are demographics; technology; the environment; and social values, behavior and ethics.

### GREATEST IMPACT

The two megatrends with the greatest expected impact on standards of conduct for investment advisers are technology and social values, with these trends being closely intertwined. The pace of technological innovation, coupled with the fact that technology is ubiquitous in virtually every aspect of life and connects the global population, makes it a megatrend.

Under the heading of social values, the report notes: "Increasingly, people are trusting 'people like me' rather than corporations or professionals and, as such, word-of-mouth and viral messages are becoming more powerful than traditional advertising. Trust is increasingly binary in nature. It is given instinctively but can be removed immediately if abused. This poses a particular challenge for the financial services industry, in which trust remains at an all-time low."

In an interview published in the March/April 2015 issue of *CFA Institute Magazine*, Tom Brown, global head of investment management at KPMG, spoke of the new "trust paradigm" and explained: "The ways that the industry can start earning that trust revolve around a focus on simplicity and transparency, as well as actually delivering on the customer service promise."

It's imperative, according to Mr. Brown, for financial institutions to get closer to clients. Advisers must understand that to be close, they need to be operating under a business model that puts them on the same side of the table with their clients.

Those who are fighting for a "right" to continue to disguise sales activities as advice are spitting into the winds of change. The bygone era that offered advantages to sales-centric businesses was based on conditions that no longer exist or will soon disappear.

*Blaine F. Aikin is president and chief executive of fi360 Inc.*

RETIREMENT WATCH

Gavin Morrissey

# The other kind of diversification

*A well-thought-out plan that takes into account tax-efficient withdrawals can be key for retirees*

Financial advisers have long touted the benefits of appropriate asset allocation as a way to provide clients with portfolio diversification while defending against market volatility. While portfolio diversification is certainly a central tenet of successful retirement planning, tax diversification can also play a primary role in achieving a client's retirement goals.

Just as a well-diversified portfolio includes a mix of asset classes, such as equities, fixed income, alternatives and cash, a tax-diversified portfolio holds assets in accounts with different tax characteristics (taxable, tax-deferred and tax-free).

Many retirement income plans are based on two common guidelines: the 4% withdrawal rule and the standard sequence of withdrawals, with taxable assets used first. Although these are appropriate starting points for many clients, scrutinizing a retirement income plan with an eye to tax-efficient withdrawals may better protect it against the inherent risks of market action, inflation, taxation and longevity.

The 4% rule aims to provide clients with reliable, sustainable retirement income for the remainder of their lives, and it's generally a sound guideline. But because no two clients or their portfolios are the same, it's important to take a proactive approach. You can't just put a retirement income plan on autopilot when using a 4% withdrawal strategy.

**THE USUAL** sequence of withdrawals may not lead to maximum tax efficiency.

For example, a client with mostly tax-deferred assets will likely require a larger percentage withdrawal to meet his or her after-tax income needs than a client whose portfolio is held in various accounts with varied tax characteristics.

**TIMING IT RIGHT**

Further, the traditionally accepted sequence of withdrawals may not lead to maximum tax efficiency for all clients.

Using the standard guideline, assets would be withdrawn from retirement portfolios in the following order: taxable assets, tax-deferred assets and tax-free assets.

The idea is to grow the tax-deferred and tax-free assets as long as possible, under the assumption that the client's marginal tax rate will fall in retirement. While this is possibly a worthwhile starting point, it may not be the most beneficial strategy for every client.

Under the current tax code, withdrawals may be subject to various levels of tax treatment. Withdrawn funds, or portions thereof, can be characterized as ordinary income, short- or long-term capital gains, tax-exempt or return of principal. Plus, some clients may be subject to an additional 3.8% Medicare surtax on certain net investment income.

For archived columns, go to InvestmentNews.com/retirementwatch

Given the potential complexity of determining a tax-efficient withdrawal strategy, it's easy to see the appeal of the straightforward ordering of withdrawals approach. Unfortunately, ease of implementation may come at the expense of a truly sustainable retirement income plan.

A significant benefit of tax diversification is the adviser's ability to control bracket creep.

For example, a married couple is taxed at 15% until their income exceeds $74,900. If their portfolio is held in various accounts with different tax characteristics, the adviser could elect to take funds from retirement accounts until they reach $74,900 while preserving other assets subject to preferential long-term capital gains tax or no tax, reducing the amount of retirement assets subject to required minimum distributions at age 70½.

Any income need above the retirement account distributions to that point could come from the more preferentially taxed portion of the portfolio, helping to ensure that the couple's marginal rate remains as low as possible.

Although this example is simplistic, creating a tax-efficient retirement income plan is not. Many clients tend to retire with large qualified plan and IRA balances, which make tax diversification challenging to achieve.

Strategies such as partial Roth conversions in lower-income years, after-tax savings in nonqualified accounts and municipal bonds are well worth looking into for advisers who wish to offer their clients the most tax-efficient plans possible.

*Gavin Morrissey is senior vice president of wealth management at Commonwealth Financial Network.*

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RECRUITMENT CONNECTION

# Head of examinations program is about to leave the SEC

By Mark Schoeff Jr.

The SEC said last Tuesday that the head of its examination program will leave the agency at month's end.

Andrew Bowden, director of the Office of Compliance Inspections and Examinations, is returning to the private sector, according to the agency.

"Under his leadership, OCIE has effectively engaged with investors and the industry to promote compliance, worked to detect and prevent fraud, and advised the commission on policy issues and developing risks," Securities and Exchange Chairwoman Mary Jo White said in a statement.

Mr. Bowden, 53, led the agency's initiative to examine private-fund advisers who had to register with the agency for the first time under a mandate of the Dodd-Frank financial reform law.

He also implemented a program to examine investment advisers who have been registered with the agency for more than three years

> "HE SUCCESSFULLY LED OCIE's efforts to better leverage its limited resources."
>
> **Karen Barr**
> President and chief executive
> Investment Adviser Association

but have never been inspected. That effort was expanded this year to include investment fund complexes that have not been reviewed.

Mr. Bowden is credited with enhancing the agency's use of data to better target risky advisers for examination.

"He successfully led OCIE's efforts to better leverage its limited resources to achieve greater impact, including strategic use of technology," said Karen Barr, president and CEO of the Investment Adviser Association.

"OCIE's examination program for investment advisers was improved, both in terms of the number of targeted, risk-based examinations performed and in terms of education and guidance for newly registered advisers," she said.

In a recent appearance at an Investment Company Institute conference, Mr. Bowden outlined an ongoing examination of payments from mutual funds to intermediaries, such as broker-dealers. The agency is trying to determine whether some of the money earmarked for investment management services is instead being used to augment marketing payments.

Mr. Bowden joined the SEC in November 2011 as head of the investment adviser and investment company examination program. He was promoted to deputy OCIE director in September 2012 and became director in June 2013. Prior to the SEC, he worked in the financial services industry and as a private lawyer.

Last Thursday the SEC announced Marc Wyatt, the deputy director of OCIE, will serve as acting director.

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**Andrew Bowden:** Led initiative to examine private-fund advisers.

# Fidelity's plan to offload clients

Continued from Page 2

investors could be really ideal to be referred from an adviser to FirstPoint."

A 2014 Millionaire Outlook study by Fidelity found that 76% of financial advisers focus their business on clients who are 49 years or older, or those with $1 million or more in assets to invest. And 45% of advisers said they have no plans to focus on emerging and mass affluent investors over the next five years.

Yet investors between the ages of 21 and 49 who have assets of $50,000 to $250,000 are well-positioned to become millionaires.

### WHERE THE MONEY IS

"There is this very natural and understandable draw for advisers to move to where the money is, and a lot of times that is with people who are a little bit older," Andreas Scott, a financial adviser at Total Wealth Advisors in Minneapolis, said. "The whole service model has been tailored to people who are boomer-aged and older and have liquid assets. That really has left out the millennial market."

And there's a disconnect between advisers and these millennial clients, said Alan Moore, co-founder of XY Planning Network, which focuses on pairing financial advisers with young investors.

> "THESE INVESTORS may have all the prospects of being millionaires of tomorrow, but they're not rich yet."
>
> **David Canter**
> Executive vice president
> Fidelity Clearing and Custody

"They just don't care," Mr. Moore said of advisers who work strictly with older investors. "There are so many young people who need an adviser, but getting them to care is beyond challenging."

Marty Bicknell, chief executive of Mariner Holdings, said many advisory firms are already referring away millennials. The deal with Fidelity, he said, will allow them to earn revenue in the process.

"Those clients that are below the minimum, what do they do with them? They typically refer them away," Mr. Bicknell said. "This gives advisory firms the ability to have incremental revenue streams from something they're already doing."

No money will change hands between Fidelity, which merged its clearing and custody units into one in February, and FirstPoint in this partnership.

"What FirstPoint is helping to do is democratize advice," Mr. Canter said. "It's really democratizing it for investors of all asset sizes."

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# Energy's mergers no sign to jump in

Continued from Page 3

stocks have been like the baby and the bath water, because everybody focuses on the price of oil and it seems like that price is still signaling that it will go lower. I think energy is one of the first areas of this market where fundamentals are starting to matter again, and the good portfolio managers are being rewarded."

Mr. Wruble touches on a basic truth about the overall energy sector: that one has to separate the commodity from the companies doing business involving it.

Crude oil, which is now trading above $50 a barrel, has recovered from a $45 trough at the start of the year. But the price is still down almost 55% from its June 2013 peak of more than $113.

"The commodity has gotten clobbered, and with it almost all the companies in the sector," said Edward Deicke, a financial adviser with JHS Capital Advisors.

### SHELL DEAL

"We think there's value in some of those companies, and that's what the Shell deal is about," he added. "That deal is the tip of the iceberg, because there will be more consolidation."

Last Wednesday, Royal Dutch Shell PLC agreed to pay $70 billion in stock and cash to acquire BG Group PLC in a deal that would create the world's largest independent natural gas producer.

For investors, in terms of gaining exposure to either future consolidation or a rebound in the price of oil, the tricky part can involve both timing and access.

"We went long on the energy service sector toward the end of last year, and that turned out to be a little early and caused some pain, but that trade is starting to look better and better," said Paul Schatz, president of Heritage Capital. "At this point, I'd say the entry point for new money is still 3% to 5% lower from here, with a potential upside of between 15% and 20%."

Mr. Schatz, who is investing in the sector through the Rydex Energy Services Fund (RYVIX) and Market Vectors Oil Services ETF (OIH), might see the category pull back to his entry-point level as first-quarter earnings start to roll in.

Consensus estimates have earnings for the sector coming in at 63.4% below the same quarter a year ago. The sector is such a negative outlier that it's dragging the consensus for the entire S&P down to a 3% year-over-year earnings decline.

Mr. Schatz knows he is stepping out on a limb by playing the energy market through oil services companies, but he is among those who believe the price of oil is on the upswing.

"The energy and oil services sector is the most leveraged to the price of oil," he said. "If you think oil is going to make a move that's the most aggressive play, but if you're wrong it can be tough."

While Mr. Schatz sees oil gradually climbing to the $60 a barrel range, a lot of investors are ready to take the other side of that trade, which further makes the case for just riding out energy-indexed exposure.

"I think oil is higher right now on faulty ideas, because there is more oil in the pipeline than they can use, which is why it's going lower," said Theodore Feight, owner of Creative Financial Design. "I would guess we are in the first year of a three-to-five year down cycle before oil comes back, and that's why I'm not buying yet."

### MORE DEALS LIKELY

In terms of energy-related companies, Mr. Feight believes the fallout has only just begun.

"It's kind of like real estate investors the way some companies thought this energy boom would last forever, so they just leveraged up," he said. "There will be more deals like the Shell acquisition because the price of crude oil and what they can sell gas at is going lower. That makes some energy companies cheaper and creates opportunities for the big companies to buy them."

BLOOMBERG

If ever there were a case for allocating to a skilled stock picker over broad index exposure, it's energy. Simply put, too many variables are in play right now for the overall sector to muscle out any kind of meaningful turnaround any time soon.

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TECH CONNECT

# Robo-advisers rushing to add latest features

*Online advice firms aim to stand out with better services*

**By Alessandra Malito**

Betterment has begun offering its tax-loss harvesting service to all its clients with no minimum balance, following Wealthfront's announcement at the end of March that it would offer such a service by the end of this month.

The mirroring of the announcements may be yet another indication of the commoditization to come in the robo-adviser space.

There has been a domino effect since Charles Schwab & Co. unleashed its disruptive Intelligent Portfolios robo-adviser in the automated online investing market. Since then, companies like Wealthfront and Betterment have locked horns with Schwab as well as each other.

**SIMILAR PRODUCTS**

In the process, established and emerging robo-advisers have begun to mimic each other, either through similar features or by echoing statements ripping into their bigger competitors.

"Eventually, the products will all be free and all [will] offer the same thing," said Mike Kane, chief executive of Hedgeable, also a robo-adviser offering.

Betterment's recent announcement on tax-loss harvesting includes the company's ability to trade in fractional shares, meaning it will take smaller pieces of exchange-traded funds for customers, and in turn manage smaller lots for customers with smaller balances.

"We can do it better than anyone else," said Jon Stein, chief executive of Betterment. "Many will try, but no one can do it the way that Betterment does it."

Wealthfront CEO Adam Nash announced at the end of March the company was rolling out its tax-loss harvesting feature to all clients in April, but Mr. Stein said the difference between the two companies is that Betterment has already started the process and Wealthfront hasn't.

"Even when they do get around to it sometime later this month, they are not making it accessible to everyone," Mr. Stein said. "They have a minimum balance and they can't do it the way we are doing it, so it's not very useful to people with smaller accounts."

Mr. Nash said offering tax-loss harvesting to all of its clients was an example of Wealthfront leading the way, and that the company was happy to see the industry react.

"At Wealthfront, we're proud that the features we bring to market have come to define our category," Mr. Nash said. "Our mission isn't just to provide better value and service to our clients, but to force the entire industry to do the same."

**SHOWING THEIR SKILLS**

April Rudin, founder of marketing firm Rudin Group, said she expects to see robo-advisers continue to try and match each other's services.

"I would expect these announcements to happen very frequently," Ms. Rudin said. "The bare minimum that these firms can offer is changing."

The only way to tell which will be successful is by waiting to see how many people use which services, she said.

And in order to gain more clients, robo-advisers will have to home in on specific skills to survive the commoditization of the industry.

"Many of them are going to struggle," said Lee Kowarski, vice president of kasina, a financial services research firm. These automated online platforms "need to ultimately try to win a competency or niche."


Now more than ever the companies will need to find ways to be different, not the same.

"When there was only one or two players to compare against traditional investing options, it was enough to be different," Mr. Kowarski said. "But now they have to tell a story about why they're going to be better suited to provide returns at a lower cost with better service."

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# Feeling good about financial life

*Guidance should help people make wise choices about saving, spending*

Guest Blog
Joe Duran

What is the difference between being wealthy and rich? It's one of the biggest questions our industry has wrestled with for many years. That's why I was quite excited to read "The Thin Green Line," Paul Sullivan's new book. Paul writes the "Wealth Matters" column at *The New York Times*, and I enjoy his perspective that usually features individuals sharing a personal story that then connects with how our industry is solving their challenge.

I was quite intrigued to see how a reporter (albeit one well-versed in our industry) would write a self-help book about investing and wealth. I am not going to review the book, but I did want to discuss the underlying concept that runs throughout it, and how it applies to our clients and to each of us as their advisers.

"The Thin Green Line" explores the difference between those who live above the line, and feel good about their financial life (regardless of the amount they have), and those who do not. In other words, what defines those people who are wealthy, regardless of how rich they are? The book is full of examples and personal anecdotes, but I was left with three big questions about our jobs as advisers:

**1. Is our job to maximize net worth, or maximize people's lives?** Most of our industry assumes that we are in the business of growing clients' savings as much as possible in a risk-conscious way. Interestingly, Mr. Sullivan argues that making conscious trade-offs and knowing what you can and can't afford is one of the most important elements to being satisfied, regardless of how much money you have. In fact, there is an underlying assertion that being overly focused on building the biggest nest egg you can might take away from living the best life you can. Our own research with individuals and families validates this opinion.

**2. Is helping our clients spend wisely as important as helping them invest wisely?** The underlying message of the book really is that people above the line work diligently to live within their means and are well prepared for life's unpleasant surprises, without sacrificing their current lifestyle. They also have clarity about what they are working for and what their money's purpose is. I don't know any competent adviser who doesn't help clients protect against bad outcomes, but how many also think that it might be just as important to give certain people permission to spend more, too? We have all seen the situation where a couple scrimps and saves their entire lives. They sacrifice their own needs and then they leave a wonderful nest egg to their heirs, who are more than happy to buy all the things their parents denied themselves (nicer homes, big vacations, etc.) It's not our job to tell people what to do with their money, but shouldn't it be our responsibility to help people have more clarity about what they are really saving money for, beyond security?

**3. Do we have too much faith in clients being rational actors?** Much of the book explores the question of why people often act in an irrational way. In other words, some folks do bad things knowing full well that there will be bad consequences. I love this subject because the ultimate dilemma for all of us is trying to help people make good financial life decisions. It's hard work for our clients to be financially disciplined all the time. Our job is ultimately to help them in making conscious choices. I like to think of a good decision as having three key elements: truth (an unfiltered, unbiased and complete set of accurate facts), understanding (objective analysis with a caring and aligned perspective) and discipline (clear, deliberate and well-executed action steps).

It's helpful to remember that while many of our clients might be rational actors when they are in our offices talking about financial outcomes, they usually revert back to their normal lives afterward.

*Joe Duran is chief executive of United Capital. Follow him @DuranMoney.*

# Subscriptions a viable payment plan?

**Continued from Page 11**
rett Planning Network. "One email can easily cause the adviser to invest one or more hours for the client, so there goes the idea that you can serve people and be there on an unlimited basis to coach them."

Subscription-based services typically work well for young clients. Those clients may not have a lot of assets, but they often need financial advice to navigate such life events as getting married, having children and buying a home.

Sophia Bera, founder of Gen Y Planning and a former LearnVest adviser, has built her practice by using a subscription-based model — but one that is significantly more expensive than what she charged at LearnVest.

By setting the bar at an upfront fee of $999 to $1,999, plus a monthly subscription fee of $99 to $199, Ms. Bera screens out clients who aren't serious about financial planning. "People didn't value [cheap financial planning]," she said. "They wouldn't get us the information on time; they'd miss their client phone calls. It wasn't a big deal to them because they paid $100."

Given new clients' frugal tendencies and their misinformed beliefs that budgeting only requires calculators, advisers need to remind them of the true value of financial planning. A lot of heavy lifting occurs during the first six months in a new client relationship — both in person and behind the scenes, Ms. Garrett said. Going forward, the adviser will have to monitor the plan and implement recommendations, so the work remains ongoing.

### LONG-TERM PLANNING

Advisers need to make clients aware of the fact that they're not just paying for a cash-flow analysis and investment expertise. Rather, those tasks are part of the ongoing work that will help those clients meet long-term planning goals.

Ms. Garrett suggests breaking out financial planning fees and keeping them separate from investment management fees. "I'm an advocate of keeping those fees separate so that people recognize that you're paying for financial planning advice, time and services," she said.

In Ms. Bera's case, planning involves more than just asking about income and assets; it's helping clients pin down long-term goals, offering to do a deep dive into employee benefits, maximizing 401(k) contributions and optimizing clients' health savings accounts. It takes time to provide that level of financial planning service, but Ms. Bera sees it as an investment in her clients and in her practice.

"When I start talking with clients, they make good choices, and when they inherit wealth they won't blow the money because they've learned good habits," she said. "If they have a windfall, they're more likely to say, 'Hey Sophia, what should we do with this? We want to set aside some for our kids' education, but we're not sure what else we should do.'"

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# Target date managers not in funds

**Continued from Page 11**
managers don't invest even one dollar in their own funds speaks for itself," Ms. Yang said.

Generally, higher levels of manager investment in their own funds tend to coincide with better results, she added.

But when it comes to 401(k) fund recommendations, how much weight do retirement plan advisers give to managers who invest their own dollars in their own funds?

Retirement plan advisers point to a wide array of factors behind why they recommend one fund family over another to a particular 401(k) client. To some extent, a fund manager's investment in his or her own mutual fund may play into that. But there are other limitations and considerations.

"From a human basis, you always want to go with those who eat their own cooking," said Aaron Pottichen, retirement consultant with CLS Partners. "But the challenge with that thought process is that for the most part, we can't decide which managers are going to be in a target date fund unless you create your own custom target date fund."

"THE FACT THAT more than half of the fund managers don't invest even one dollar in their own funds speaks for itself."

**Janet Yang**
Director of multi-asset-class research
Morningstar

### EMOTIONAL FACTOR

Another thing to consider is that while it's intuitive for advisers to want to suggest a fund manager who invests in his or her own target date funds, there's the flipside of the argument: Could they be subject to decisions based on emotion due to the amount of money they have invested?

"When all of my money is in the fund, I can make the point that I'm more emotional about my money and less objective about it," said Philip Chao, consultant of benefits and investments at Chao & Co.

Advisers noted that while the extent to which a manager has skin in the game is a consideration, they also look at expenses and manager compensation when making recommendations. Mr. Chao, for instance, said the metric used to determine managers' pay is a bigger deal than whether he or she decides to invest in the fund.

"Is the compensation tied purely to performance? If it's purely on appreciation, then you may inadvertently take more risk because you want a higher percentage of return vis-à-vis if you're compensated differently against the benchmark," Mr. Chao said.

Mr. Pottichen, meanwhile, considers expenses and a given fund family's fit for a plan's demographics. "It might make sense to use a fund with a higher equity allocation at age 65," he said. "We look at the demographics of a group: For people who are older, do they need a more aggressive allocation? Is that provided by the target date fund that we're recommending?"

### COST IS KING

Costs remain a big deal. "If I have two target date funds that I'm considering and the manager was invested in one and paid off the performance and the other fund didn't have those things but was lower cost, I'd go for lower cost," Mr. Pottichen added.

Separately, some said they couldn't recommend target date funds without feeling like they were in the game with their 401(k) clients. George Fraser, managing director at Retirement Benefits Group, said he invested all of his 401(k) assets in a target date fund. "If I'm not doing it, then why suggest it for the employees that I'm working with?" he asked.

Though advisers didn't give a lot of weight to whether target date fund managers invest in their own products, the issue mattered to the managers who partake in that strategy.

Jim Lauder, CEO of Global Index Advisors, a subadviser to Wells Fargo's Advantage Dow Jones target date funds, invests in the target date fund himself. "If you believe in what you're doing, then it's logical that you have some significant funds in your own strategies," he said. "It should be good for you if you think it's good for others."

He added that the Wells Fargo target date series is in fact the qualified default investment alternative in the firm's retirement plan. "At the end of the day, legions of people invested in target date funds take a step back and see how the organizations are using them," Mr. Lauder said.

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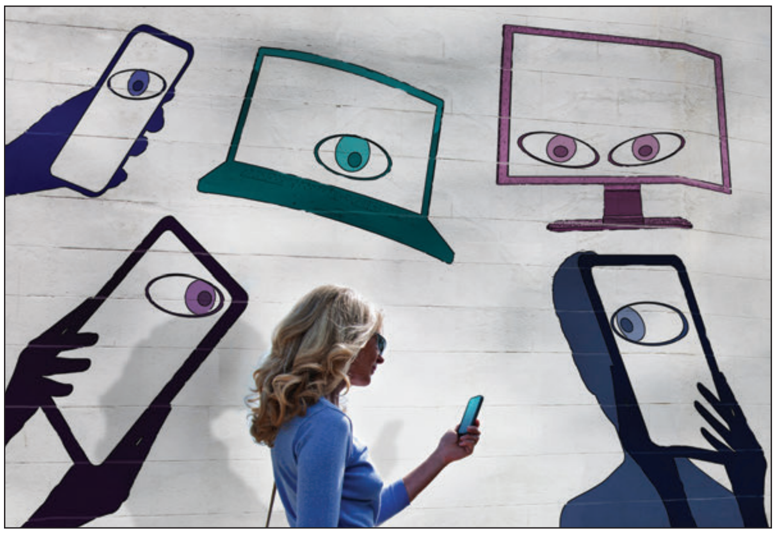

GETTY IMAGES

# SEC panel pushes massive database

By Mark Schoeff Jr.

The Securities and Exchange Commission should develop a database that compiles information about securities law violations and is easy for investors to use, especially the elderly, an advisory group said last Thursday.

In its quarterly meeting at SEC headquarters, the SEC Investor Advisory Committee floated a proposal to have the SEC work with other federal and state financial regulators to develop a single website to house disciplinary information about investment advisers, brokers and other financial professionals. As a step toward that goal, an IAC subcommittee suggested the agency provide a single portal for investors to access information in SEC and Finra databases.

The proposal likely will be voted on by the full IAC at the group's July meeting.

### MORE ACCESSIBLE

The goal is to increase the amount of information available online about financial advisers and make it more accessible, said Anne Sheehan, director of corporate governance at the California State Teachers' Retirement System and chairwoman of the IAC subcommittee.

"This is something from an investor protection perspective, which certainly is the mission of this committee, [that] can play a very important role for the public," Ms. Sheehan said.

Established by the Dodd-Frank financial reform law, the IAC is comprised of 21 market participants, academics, consumer advocates and other experts, and is designed to represent the voice of retail investors.

The panel's effort was endorsed by SEC member Kara Stein, who said all infractions by financial advisers should be made more easily accessible and located in one place.

"I don't think an investor should have the burden of ferreting out all possible disciplinary actions from a variety of databases — some that are available easily and some that are not," Ms. Stein said. "I'm concerned right now that investors are left Googling financial representatives to find out if they've been disciplined."

But she noted that a Google search would not take an investor to BrokerCheck, the database of registered brokers maintained by the Financial Industry Regulatory Authority Inc., the industry-funded broker-dealer regulator. Google also would fail to turn up the SEC's Investment Adviser Public Disclosure database, which contains background on registered investment advisers.

The databases are not open-source and do not pop up in Internet search engines. They do work together. For instance, investors who input a broker name on the SEC site will be taken to BrokerCheck for the results.

The IAC said the system is confusing and the SEC should consider creating a single site, perhaps named "AdviserCheck," where investors could access IAPD, BrokerCheck and other websites overseen by the SEC.

One weakness of the SEC and Finra sites is that they contain information only on people who are registered with the agencies, the IAC said.

"A significant gap is that the two databases do not include unregistered firms or persons sanctioned by the SEC or state securities commissions, even those sanctioned for operating as an unregistered broker or adviser," the IAC said in its draft recommendations.

The IAC said the SEC should bring together all regulators to give investors one-stop shopping for information about financial professionals.

> "I'M CONCERNED ... investors are left Googling financial representatives to find out if they've been disciplined."
> **Kara Stein**
> SEC commissioner

"The SEC should act as the catalyst for the construction of a single site that would provide for searches of databases maintained by itself and other financial regulators," the IAC said.

Last November, the Commodity Futures Trading Commission launched SmartCheck, an investor education website that provides links to the SEC and Finra databases, among others.

The decision on an investment professional is the most important one that investors will make, and they need to be able to conduct more robust background checks, said Barbara Roper, director of investor protection at the Consumer Federation of America and an IAC member.

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# Stifel may be shopping for more B-Ds

Continued from Page 1

The makeup of Sterne Agee's workforce is especially important to Stifel, because it is picking up about 630 reps in the independent channel. Of its existing 1,943 advisers, only 188 are in the independent model. Adding the Sterne Agee reps will put Stifel is a better position for further expansion in this growing part of the advice business.

Until the Sterne Agee deal, most of Stifel's acquisitions were in areas other than retail brokerage. In fact, of the 16 acquisitions it has inked since 2005, only three have been primarily in the brokerage business. In 2007, it bought Ryan Beck Holdings Inc., a full-service brokerage and investment banking firm. The next year it bought broker-dealer Butler Wick & Co., and in 2009, during the fallout from the financial crisis, Stifel acquired 56 branches from UBS Wealth Management.

### STIFEL'S ARCHITECT

The architect of Stifel's growth strategy was the chief financial officer at Robert W. Baird & Co. before joining the firm in 1997 as president and CEO. A former accounting major from Indiana University — he was the first in his family to attend college — Mr. Kruszewski is active in community affairs in Stifel's hometown of St. Louis, often helping to raise funds for local charities.

"Ron is a fun guy but a serious business person," said Michael Keller, executive director of the Independence Center of St. Louis, which helps adults with mental illness. "I think he's positioned Stifel as a leading business here on the philanthropic front."

Mr. Kruszewski will not tip his hand about future acquisitions.

"We want to build a premier investment bank and wealth management firm," he said. "I will see the growth when the next opportunity presents itself. When and where that will come from, I have no idea."

A lot may depend on what is available — and at what price.

"To do $5 billion in revenue would be easy," Mr. Kruszewski said. "We would just have to buy everything. But that won't grow the stock."

> **$150M**
> Amount Stifel paid in cash and stock for Sterne Agee

The Sterne Agee acquisition is a good example of Mr. Kruszewski's modus operandi. Sterne Agee was under a cloud for most of the past year. Its board last May fired chairman and CEO James Holbrook Jr. for allegedly misusing company assets and spending lavishly on perks. The board took the action after it learned of a federal criminal investigation into possible misconduct by the CEO.

Stifel paid $150 million in cash and stock for Sterne Agee, in a deal that was greeted with enthusiasm on Wall Street. After it was announced, Stifel's stock climbed 7%.

"Stifel has a history of picking up companies when they are near a trough in earnings or when they need to scale up," said Michael Wong, an analyst with Morningstar Inc.

He pointed to two deals in the wake of the financial crisis. In 2010, Stifel acquired an investment bank known for its expertise in technology, Thomas Weisel Partners. Three years later, it bought middle-market investment bank Keefe Bruyette & Woods. Both firms were losing money.

That strategy has served shareholders well. In the past 10 years, Stifel's share price has increased 295.5%, while Raymond James Financial's shares have increased 182.4% and Morgan Stanley's shares have sunk 35.1%.

"Stifel could continue with its roll-up type of strategy and integrate other regional wealth management firms," he said.

While Stifel is acquisition-minded, Mr. Wong said Mr. Kruszewski is unlikely to pull the trigger if a deal isn't right. He said Stifel was one of the firms in the running to acquire retail brokerage Morgan Keegan & Co., a firm eventually bought by Raymond James.

"Raymond James won it, but Stifel was in it but walked away," Mr. Wong said. "The examples of what they have done in M&A and what they have passed on shows Ron is a disciplined and experienced acquirer."

Mr. Kruszewski clearly leaves the door open for more acquisitions in the future. "Are we going to grow?" he asked. "The answer to that question is, the past is the prologue. Look at what we've done. We've been a growth story for 17 years."

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# Exchange

BLOOMBERG

Continued from Page 1

issue, on what traders described as a quiet day of trading, is impossible to determine. Some other traders and portfolio managers said they were not greatly affected. But investors who look at performance data produced on the basis of market-at-close ETF prices at the end of the quarter will see unexpected results.

The full reasons behind the March 31 glitch at NYSE Arca, a major electronic bourse for ETFs in the U.S., have not been disclosed. A spokesman for the exchange, Eric Ryan, declined to comment, pointing to a brief alert sent out that day to traders.

Vanguard said the closing prices of three of its ETFs, including VUG, saw closing market prices that deviated unexpectedly from the value of their underlying holdings on March 31. VUG had a price equivalent to a discount of 2.77% on its underlying value. The Vanguard Mid-Cap ETF (VO) had a price 3.05% higher than its underlying stocks and cash. And the Vanguard Small-Cap Growth ETF (VBK) had a discount of 1.49%, according to a statement by Vanguard.

Typically, those funds trade at premiums or discounts that are magnitudes smaller, measured in the one-hundredths of a percentage point. The three funds manage $34 billion and, on an average day, account for about $169 million in trades, according to ETF.com, a researcher.

When large premiums or discounts develop, large traders generally step in and effectively either create or destroy ETF shares until they trade closer in line with their value. But to do that, they want to insure against, or hedge, their risks by trading other securities.

It's difficult for them to do both at the same time at the close, because ETFs and their underlying stocks stop trading for the day at the same time. In order to prevent price discrepancies, exchanges generally provide information around the market's close that helps them anticipate and hedge against market imbalances.

### DATA LACKING

That didn't happen on March 31. Instead, traders lacked certain data on a range of Arca-listed securities — falling alphabetically from the ticker symbols UTG through ZSML — which had stopped trading earlier because of related difficulties.

The issue is a reminder of the importance of best practices in trading ETFs and of explaining the occasional quirks of the market to clients, according to Joel M. Dickson, global head of investment research at Vanguard.

Echoing a number of other ETF analysts, Mr. Dickson said investors should use extra caution — or avoid trading altogether — around the market open or close. And he said they should use limit orders, rather than market orders, to insure proper trade execution.

"This really was not an ETF issue," he said. "It was a technology failure at the exchange that could've affected a whole different set of securities."

But the issue comes as more advisers are learning how to use ETFs properly. The funds now manage $2 trillion and work very differently from mutual funds, a product from which they are draining market share. Investors in open-end mutual funds always buy and sell shares at a price equal to their underlying net asset value.

"There's a lot of these weird things in ETFs," said Matthew Tuttle, chief executive at Tuttle Wealth Management and an ETF strategist. "Because ETFs are still new and still different, I think that it's really an obligation for the ETF issuers to help out because bad trades reflect badly on us."

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