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MICHAEL MORGENSTERN

Spotlight

Emerging Markets: Where to find opportunities, and how to capture them. **Pages 12-15**

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KAM TAI / ISTOCK

THE HIDDEN THREAT OF ROBO-ADVISERS

Automated investment platforms are mounting a sneak attack against 'safe' parts of your business

By Mason Braswell and Alessandra Malito

LIKE MOST MARKET DISRUPTERS, robo-advisers don't mind being underestimated. In fact, they're counting on it.

When the latest iteration of automated investment services first appeared on the scene in the late 2000s, it was summarily dismissed by detractors as a fad — a ridiculous, albeit inevitable, byproduct of investor overconfidence brought on by a prolonged bull market.

EDITORIAL
Advisers should step cautiously into the robo-world.
Pages 8

The idea that consumers would turn to mathematical algorithms for investment advice was laughable. In fact, at an industry gathering in 2014, a human dressed as a robot took the stage and announced plans to replace financial advisers.

"I am Robo-Adviser," said the fake robot in a robotic voice. "You can call me at 3 a.m. I never sleep. I will manage your money."

The audience, which was made up of mostly financial advisers and technology vendors, roared.

In the end, however, it may be robo-advisers who have the last laugh.

Helping investors to decide how to allocate their assets

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Agency overpaid 1,013 beneficiaries $12.4 million because of outdated records.

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EDITOR'S NOTE

Endgame for robos starts to take shape

You don't need me to tell you that robo-advisers are a "thing."

Sure, firms like Betterment and Wealthfront, which are probably the purest form of robo-advisers, have been offering simple, low-cost investment advice to middle-market investors for years. But it's only in the last few years that they have really captured the imagination of the financial advice industry.

Frederick P. Gabriel Jr.

At *InvestmentNews,* we've written extensively about robo-advisers. In fact, our first big story appeared in November 2013, in a cover story entitled "The Future of Advice."

Since then, we've written hundreds of stories about online registered investment advisers and the opportunities and challenges they pose to the advice industry. We've also incorporated content related to robos into various webcasts and conference sessions that we have hosted.

InvestmentNews' research group has also looked closely at how real-life advisers are reacting to the robo phenomenon. In fact, our 2015 Elite RIA Study, which is being released this week by *InvestmentNews* Research in partnership with BlackRock Inc., has a whole section that examines how top advisers feel about robos and, more importantly, how they are taking advantage of their increasing popularity.

HYPERBOLIC TALK

In putting together our plan for this week's Page 1 story, we aimed to advance the conversation beyond all the hyperbolic talk about fees and whether robos will survive a prolonged market downturn. Our goal was to give readers a better idea of where all this was going. What is the ultimate endgame for robos and how will that affect flesh-and-blood advisers?

What we found is that most robo-advisers have ambitions far beyond investment advice. Though it might seem farfetched (and admittedly, it does), most robos are considering how they might go head-to-head against real-life advisers by offering services that look more like planning than investment advice.

No doubt there will be many who will dismiss the threat of robos' advance into planning as utter nonsense. But they likely will be proven wrong.

Make no mistake: The emergence of robo-advice is a game changer and is likely to have unforeseen consequences on the business of providing advice.

Don't believe me? Consider the effect that online retailers such as Apple's iTunes and Amazon have had on the music industry. CDs, once the dominant form of music distribution, are now hanging by a thread.

Better start singing a different tune.

fgabriel@investmentnews.com, Twitter: @fredpgabriel

Pol urges 'war' on fiduciary rule

Missouri Rep. Wagner threatens DOL's budget if it doesn't relent

By Mark Schoeff Jr.

BLOOMBERG

Rep. Ann Wagner: In speech before NAIFA, fired up members against DOL proposal.

A leading opponent of the Labor Department proposal to raise investment-advice standards for brokers working with retirement accounts is pursuing an aggressive strategy — that includes denying the agency funds to implement it — to stop the rule.

"We are at war with the Department of Labor," Rep. Ann Wagner, R-Mo., told the audience at a National Association of Insurance and Financial Advisors event last Tuesday in Arlington, Va. "I need you to be tough."

Ms. Wagner was firing up NAIFA members before approximately 800 of them set out last Wednesday to visit with lawmakers and their staffs on Capitol Hill. The priority for those meetings was to persuade members of Congress to oppose the DOL rule, which would require brokers to act in the best interests of their clients when advising on 401(k) and individual retirement accounts.

Like NAIFA and other industry opponents, Ms. Wagner argues the rule would significantly raise regulatory and liability costs for brokers and price them out of serving the middle-income market of retirement savers.

EXTENDED COMMENT PERIOD

The proposal was released in April with the strong backing of President Barack Obama, who asserted that the rule would protect workers and retirees from conflicted investment advice that puts high-fee products in their portfolios that eat away at their nest eggs.

Last week, the DOL added 15 days to the initial comment period, under pressure from the financial industry and bipartisan members of Congress.

Although the presidential imprimatur has given the rule momentum, Ms. Wagner told NAIFA members there is a three-pronged effort to halt it.

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Schwab sweetens its 529 plans, cuts fees for active and passive portfolios

Expense ratios lowered by an average 20% on active products, 45% on passive

By Srividya Kalyanaraman

If clients are thinking about college savings, Charles Schwab & Co. Inc. just got their attention by slashing fees in its 529 plans.

In actively managed portfolios, Schwab is lowering its fees by an average 20%. Expense ratios that were 0.41% to 1.34% now will be 0.41% to 1.01%.

It is cutting passive index portfolio fees by a larger percentage — 45% — to 0.30% from 0.55%.

Schwab offers seven actively managed funds and six passive index portfolios, which are a combination of Schwab and third-party funds.

As college costs continue to rise, the financial industry is making offerings like these commonplace. Earlier this month, online investment platform FutureAdvisor started offering free college savings plans.

Schwab's move comes at an opportune time — the amount saved for college was down 25% in 2014 due to parents' incurring unexpected expenses combined with lower earnings.

Such 529 plans offer a number of benefits, including tax-deferred growth and tax-free withdrawals when used for college expenses. The Senate Finance Committee last month approved some changes to the 529 program, including allowing refunds to be reinvested into plans within 60 days without a penalty.

The full Senate is expected to pass the bill, which already was approved by the House. It would then go to President Barack Obama, who is expected to sign it.

BLOOMBERG

Supreme Court hands down decision in key 401(k) lawsuit

Ruling underscores the need to assess plans' fund lineup, fees regularly

By Darla Mercado

The Supreme Court handed down a decision on a key 401(k) lawsuit last Monday, and the takeaway for retirement plan advisers is a simple one: Keep a close eye on your recommended fund lineups and review your contracts with plan sponsors.

The retirement plan industry has been eagerly awaiting the outcome of Tibble v. Edison, a suit that was initially filed in 2007 and was among the first lawsuits brought by employees against their employers for fee-laden funds in the 401(k) plan.

In this case, the participants had claimed that their retirement plan had a selection of 40 funds, six of which were retail share class funds and thus more costly than institutional share class funds. In 2010, the U.S. District Court for the Central District of California granted the plaintiffs a judgment of $370,732, stemming from damages related to high fees in three of the retail share class funds. Litigation on the other three funds moved to the 9th U.S. Circuit Court of Appeals and eventually to the Supreme Court.

At the center of that conflict is the question of whether the six-year statute of limitations on breach of fiduciary duty (a stipulation of the Employee Retirement Income Security Act) protects plan fiduciaries from keeping imprudent investments in the plans if those funds were added more than six years ago.

In its decision, the Supreme Court referred back to the common law of trusts, "which provides that a trustee has a continuing duty — separate and apart from the duty to exercise prudence in selecting investments at the outset — to monitor, and remove, imprudent trust investments." The higher court then sent the case back to the 9th Circuit to consider the plaintiffs' claims that Edison breached its duties within the six-year period, "recognizing the importance of analogous trust law," according to the decision.

So what does that mean for advisers who work with plans?

SCRUTINIZE EVERYTHING

There are takeaways for plan sponsors, as well as advisers at broker-dealers or RIA firms, according

Continued on Page 22

SEC proposes more disclosure on SMAs, use of social media

By Mark Schoeff Jr.

The Securities and Exchange Commission last Wednesday unanimously proposed a rule that would require investment advisers to disclose more information about their use of separately managed accounts and their social media activities.

The rule changes would require an adviser's agency registration form, or Form ADV, to include more information about assets held in SMAs and their use of leverage and derivatives. They also would require more information about branch office operations and, for the first time, make advisers list social media accounts on their ADV.

The reporting requirements on SMAs would be greater for advisers with more than $10 billion in the accounts than for those who have between $150 million and $10 billion.

As part of the reporting proposal, the commission also would require advisers to maintain performance records on accounts and securities recommendations that are distributed to any person. Currently, advisers have to keep those records only when the performance information is distributed to 10 or more people.

> "THE COMMISSION needs a wider and deeper lens to assess possible risks."
>
> **Mary Jo White**
> Chairwoman
> SEC

SEC Chairwoman Mary Jo White said SMAs are becoming increasingly popular among the 11,500 investment advisers registered with the agency.

"Approximately 73% of registered investment advisers manage a wide variety of client assets in separately managed accounts, and the commission needs a wider and deeper lens to assess possible risks," Ms. White said.

Robert Grohowski, general counsel at the Investment Adviser Association, said he was reassured that the commission indicated it would try to make the additional reporting requirements as easy as possible for adviser compliance.

"As long as regulators are getting the information that they need and the public is getting the information it needs, and they're getting it in the most efficient way possible, then I

Continued on Page 27

Sen. Marco Rubio: "I'm not poor, but I'm not rich, either."

BLOOMBERG

Rubio taps his 401(k), shocking some advisers

Senator says he needed money to buy appliances

By Mark Schoeff Jr.

Investment advisers blanched at the thought that Sen. Marco Rubio, R-Fla., would cash out one of his retirement accounts, in part to buy appliances.

On May 15, Mr. Rubio filed a financial disclosure showing he withdrew $68,000 from a retirement plan he had with a law firm where he previously worked.

On Fox News on May 17, he said he needed the money for his White House run as well as to replace a refrigerator and air conditioning unit and for his children's college costs.

"I would recommend against it, but I certainly understand it," said Paul Auslander, director of financial planning at ProVise Management Group.

By withdrawing the retirement money early, Mr. Rubio will have to pay a 10% penalty as well as regular income taxes. It's a move that advisers usually counsel their clients not to make.

"It's never a good idea," said Chris Chen, an adviser at Insight Financial Strategists.

In his own defense, Mr. Rubio noted it was just one of his retirement accounts. He's continuing to contribute part of his Senate salary to a federal retirement program.

"I'm not poor, but I'm not rich, either," Mr. Rubio said on Fox News.

'AN EVERYDAY GUY'

Mr. Rubio has been in public service most of his career — in the Florida state legislature before winning his Senate seat — with short stints at law firms. During that time, his family has lived in Miami.

"Marco Rubio is a normal, everyday guy raising a lot of kids in an expensive city," said Mr. Auslander, who is president of the Florida chapter of the Financial Planning Association.

Advisers said Mr. Rubio should find a source other than his 401(K)

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Social Security's 'minor' $12.4 million error

1000-plus received that much in unwarranted spousal benefits

IN Blog
Mary Beth Franklin

With more than 2,700 rules governing Social Security benefits, it's amazing that monthly payments to 59 million beneficiaries — including retired and disabled workers, their spouses, dependent children and survivors — go as smoothly as they do.

But with more than $800 billion a year in Social Security payments at stake, even minor errors can add up to big bucks.

For example, a recent report by the Office of the Inspector General of the Social Security Administration found that the agency improperly paid 1,013 beneficiaries an estimated $12.4 million in spousal benefits that they were not supposed to receive because they were subject to Government Pension Offset rules.

And if the error is not corrected, the agency will continue to pay those 1,000-plus individuals about $2.5 million a year in improper benefits.

In addition, the audit report identified 7,794 spousal beneficiaries who could have received some Social Security benefits because their monthly benefits exceeds their current GPO amount by at least $100.

REDUCES BENEFITS

The GPO rule reduces monthly Social Security benefits for spouses and surviving spouses who receive a government pension based on employment where FICA taxes were not paid. The GPO reduction is generally two-thirds of the government pension.

If two-thirds of the government pension is equal to, or more than the monthly Social Security spousal or survivor benefit, the beneficiary will not receive their Social Security spousal or surviving spousal benefit and the agency will suspend the individual's benefits. But if the monthly spousal amount increases and exceeds the GPO amount, the Social Security Administration must

Continued on Page 27

Financial scam artist sentenced

By Trevor Hunnicutt

A St. Louis-area financial pitchman has been sentenced to serve nine years in prison and pay more than $3.6 million in restitution to clients who participated in a real-estate investment program he used to pay personal expenses and salaries.

Prosecutors said Bryan C. Binkholder used YouTube videos, a talk-radio show and books such as the "The 401(k) Conspiracy" to cultivate clients in a fraudulent "hard money lending" program.

Mr. Binkholder — also known as "The Financial Coach" — said he would act as a bank for real-estate developers looking to purchase, renovate and resell homes.

The adviser made only a limited number of those loans, instead using the millions to pay personal expenses, interest to other investors and a salary for his wife, prosecutors said.

> "SINCE I have a license and am a little out there with the radio, frankly, it's made us more visible."
>
> **Bryan C. Binkholder**
> From an email to a colleague presented as evidence

"The only thing we've done is trying to be business people — fund loans and scratch together money from all sources which 'to the letter of the law' with securities is 'commingling,'" he said in an email to a colleague that was presented as evidence. "Since I have a license and am a little out there with the radio, frankly, it's made us more visible."

The fraud occurred from approximately 2008 to 2013, according to a grand jury indictment.

Mr. Binkholder, of Wentzville, Mo., also was affiliated with an adviser background check website that drew fire from advisers who were asked to consent to and pay for background checks on themselves. The website no longer exists.

"This is a case where the sentence, I believe, was draconian when contrasted to similar offenses and sentences handed down in connection with them," said Albert S. Watkins, a lawyer at Kodner Watkins who represented Mr. Binkholder.

"Mr. Binkholder was not a Bernie Madoff type. The amounts involved were obviously significantly less, for one, and two, this is a man who did not take money for the purpose of enriching himself personally or driving fast cars or living a loose life with wayward women or engaging in a lavish lifestyle." Mr. Watkins said.

A filing indicated that Mr. Binkholder plans to appeal the sentence and noted that his family is "forced to live off public assistance" due to his incarceration and that he has an 80-year-old mother.

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BLOOMBERG

Gundlach: Unconstrained fund managers take too much risk

By Trevor Hunnicutt

Jeffrey Gundlach is warning investors that they may not get what they expected out of mutual funds engineered for an era of rising interest rates.

The DoubleLine Capital founder said last Tuesday that unconstrained bond funds, whose managers are given wide latitude on their investment selections, are delivering a "mixed bag of results" under the spotlight of bond market volatility.

"What's going to happen is that unconstrained investors are going to find themselves disappointed," Mr. Gundlach said in an interview with *InvestmentNews*. "I think they will be surprised that they are actually doing worse in many of these funds — in 2015, as interest rates are rising — they're doing worse than they would in an index fund."

The closely watched fund manager's remarks come as the performance of some of his peers' has slipped amid a market rout that has driven some bond prices lower.

Bill Gross' Janus Global Unconstrained Bond Fund (JUCAX) and the $22 billion Goldman Sachs Strategic Income Fund (GSZAX) have delivered negative returns so far this year. The funds' managers did not respond to a request for comment.

SHORT TREASURIES

At the heart of Mr. Gundlach's concerns is managers' use of a potentially expensive short on Treasuries, the cost of which weighs on returns.

The trade is used to achieve negative duration and benefit from rising rates, and it is often coupled with low-credit junk bonds of the same maturity as the shorted Treasuries. (Duration measures the potential sensitivity of a bond's price to rate increases.)

Mr. Gundlach described that trade as an "unacceptably high commitment to credit risk" that's "long credit risk and short safety."

"Investors are probably encouraged to believe the funds will always go up, and I think that's poor communication on the part of the sponsors," he said. "I'm quite sure that investors are being told that these are strategies that have a better prospect for rising rates than other, traditional funds."

Morningstar Inc.'s nontraditional

Continued from Page 28

Smart-money tactic for clients: 45% alts

Making alternatives the core will raise eyebrows

For a lot of financial advisers, a 5% or 10% allocation to alternative investments is still viewed either as pushing the limits or as checking off the box for having some exposure to alternatives.

But what about a 45% allocation that represents the core of a client's investment portfolio?

That's the model employed by a lot of multibillion-dollar endowments and foundations, and it's the model being rolled out for individual investors by Dick Pfister, chief executive and president of AlphaCore Capital.

It is a strategy that is sure to attract plenty of critics and naysayers, particularly among advisers who believe the stock market can grow to the sky and bonds can still be measured by past performance.

But at this point in the market cycle, with stocks riding the second-longest bull market since World War II and bond yields pegged to an unprecedented Fed-imposed floor, alternatives are starting to look like the more conservative play.

> "IT'S NOT always right to have half your portfolio in alternatives, but it is right now."
>
> **Bob Rice**
> Managing director
> Tangent Capital

"I think advisers should be embracing a lot of alternative exposure, because in this environment, a large allocation to alternatives is fundamentally correct," said Bob Rice, managing director at Tangent Capital.

"It's not always right to have half your portfolio in alternatives, but it is right now," he added.

Mr. Pfister, one of the founders of Altegris mutual funds, came to this realization within his own portfolio model a few years ago after his fund complex was acquired and he was left with a pile of money he needed to invest.

What he found was that a lot of financial advisers and wirehouse representatives were pushing the same stale portfolio of 60% stocks and 40% bonds.

KNOWLEDGE VOID

"You might find a guy who would put 10%, or maybe 15%, in alternatives and that would be considered really aggressive," he said. "I realized there is a huge void in the knowledge level among financial advisers with regard to alternatives."

Like a lot of true believers in the alternatives camp, Mr. Pfister's strategy is based less on outperformance objectives and more on risk management.

What a lot of advisers don't seem to recognize is the risk of just sitting in what are often perceived as the least-risky assets. In other words, long-only stocks and bonds.

Mr. Pfister lays out a scenario of a 55-year-old in 1999 with $1 million invested in the Russell 3000, and hoping to retire this year.

Assuming he was able to stay invested through the peak of 2000, through the 32% decline to the trough of 2003, then another ride up

Continued from Page 28

Puerto Rico case costs UBS $1M

Conservative investor encouraged to keep his fortune in failing bonds

By Mason Braswell

UBS Wealth Management and its Puerto Rico unit have been ordered to pay an investor $1 million in damages after an arbitration panel said brokers encouraged him to invest 100% of his portfolio in risky, proprietary closed-end bond funds.

Juan Burgos Rosado, a 66-year old "quintessential conservative investor," according to the panel, lost $737,000 of his nearly $1 million portfolio when the value of UBS' Puerto Rico municipal bond funds collapsed in the fall of 2013. The loss took out most of what Mr. Rosado had saved from his career buying and repairing properties and running a shop, the panel said.

"Claimant's lifetime pattern has been one of frugality, saving and employment of resulting capital and his own labor in business opportunities that he understands can earn a good return," the panel wrote. "This account was extremely overconcentrated and clearly unsuitable."

The award includes $600,000 in compensatory damages and an order that UBS must also pay roughly $400,000 to buy back Mr. Rosado's portfolio. It did not, however, grant the $1 million in punitive damages he requested.

> "CLAIMANT'S lifetime pattern has been one of frugality, saving and employment of resulting capital and his own labor in business opportunities."
>
> Text of arbitration award

'SKINNY COW'

But the panelists did include a lengthy justification for their award, indicting UBS' sales practices and noting how the firm's brokers were pressured to sell the funds and keep clients invested. When Mr. Rosado approached UBS in September 2013, concerned about the declines in the fund after the balance had fallen around $200,000 to $816,000, the branch manager told him, "even a skinny cow could give milk," according to the award.

"Claimant expressed concern that the cow would die, but nevertheless held on and continues to hold on," the panel said. "He did not know that brokers were under pressure to sell these closed-end funds and to encourage customers with them in their accounts to keep them."

"So while we do generally ascribe to the concept of an investor assuming the risk of an account after sufficient notice of its risk, we do not think it applied to this investor," the panel added.

UBS also provided Mr. Rosado with investment brochures and monthly statements in English despite the fact that Mr. Rosado had limited fluency and requested documents in Spanish, the award stated.

UBS spokesman Gregg Rosenberg wrote in an emailed statement

ISTOCK

UBS Puerto Rico: Brokers pressured to sell closed-end municipal bond funds.

that the firm was "disappointed" with the decision and disagrees with the award.

The decision was released as awards related to the Puerto Rico bond funds begin to trickle in. More than $1.1 billion in damages have been alleged so far, according to UBS' quarterly reports.

The funds, which the firm said had performed well for two decades, rapidly lost value starting in August 2013 as investors became skeptical of Puerto Rico's ability to pay down its debts. UBS had sold more than $10 billion of the funds through 2012, according to marketing materials.

The firm did not expect that it

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VIEWPOINT

EDITORIALS

Step cautiously into the robo-world

REGULATORS ARE warning the public to be cautious when engaging with robo-advisers. Human advisers would be wise to take the same tack.

The sentiment in the industry about online financial advice has run the gamut from contempt to fear to giddy enthusiasm. At one point, some advisers saw development of automated, algorithm-based investment services — with their efficient, cost-effective features — as a threat to their own more traditional (and costly) one-on-one planning.

Then a lightbulb moment occurred when such platforms started being rolled out to advisers themselves. Suddenly a whole segment of the population advisers couldn't serve profitably became potential customers. Prospects with few assets who would ordinarily be turned away could now be brought into the fold — especially those who didn't need the complex planning or hand-holding that consume so much valuable time. A human adviser with a tech counterpart could expand the client pool exponentially.

As the cyborg analogy took hold, more advisers grasped the huge opportunities in matching the best of their human abilities with super-fast automation under one business model. The future was now!

OK, everyone, calm down. Take a deep breath. Reason often needs to be inserted when this kind of zeal gets whipped up and the pendulum swings so dramatically from one extreme to the other.

Sure, robos can become a real money-making opportunity, as is often the case with productivity gains ushered in by technology. But don't ignore the costs.

In their joint alert to investors earlier this month, the Securities and Exchange Commission and the Financial Industry Regulatory Authority Inc. warned about certain risks particular to engaging with robo-advisers.

A few key takeaways also apply to advisers.

No. 1: Know thy tool. Backward and forward.

Advisers looking to bring a robo-platform into their practice have many options, which are only growing with every passing quarter. Several of the biggest custodians offer third-party robos, such as Fidelity Investments (through Betterment) and TD Ameritrade Inc. (through multiple vendors). And Charles Schwab Corp. is planning to roll out its digital platform for advisers this quarter. The point is that each offering has pros and cons, and knowing them thoroughly is critical.

And it's not just about what's best for your business. The fact that regulators are paying attention means advisers acting as fiduciaries better darn well be sure any use of a particular robo is in their clients' best interests.

REMEMBER: Advisers should use the robo-tool, not be used by it.

What exactly are the terms when it comes to incremental fees, and what conditions are placed on investing options? What assumptions about your clients are baked into asset allocation decisions?

No. 2: Security. Check it or suffer the consequences.

Any third-party tools must be vetted. Though custodians and others offering the services no doubt looked into the products carefully before including them on their platforms, the buck stops with the adviser.

In addition to asking about the robo-platform's cybersecurity efforts, advisers should create their own security policy detailing potential threats and recovery plans.

SUPERCOMPUTING

Advisers have taken advantage of digital computing for decades with software and web applications. But the particular risks associated with robo-advisers must be weighed and mitigated on their own.

As Mason Braswell and Alessandra Malito point out in their cover story this week, there remains plenty to fear about the potential future of the robo-movement. Is the buddying up (or buttering up) of traditional advisers by the robos simply a Trojan horse that ultimately gets them to relinquish assets?

In addition to considering the long-term picture, advisers shouldn't lose sight of realities today. Remember: Advisers should use the robo-tool, not be used by it.

So get excited about the opportunities this new technology opens up, but be critical.

Is the platform you are reviewing the best option out there for you? How so? Are costs competitive? How much of the burden will it take off your shoulders in return for the implicit and explicit costs? Do its features address the needs of your current clients and, more importantly, the ones you hope to begin serving with such a tool?

Finally, can you live with the assumptions it will make in asset allocation decisions, and will those benefit clients? Your responsibility to them cannot be offloaded, whether clients rise to the level of personal service or not.

Duty to retirement plans expanded

The Supreme Court just increased the burden on anyone who serves as a fiduciary to a defined-contribution plan.

Advisers with clients who are sponsors of, or serve as trustees to, 401(k)s and other defined-contribution plans should advise those clients of the Supreme Court's ruling that they have a "continuing duty to monitor trust investments and remove imprudent ones."

And any financial advisers who provide guidance on investments to such plans also should be aware of the decision's implications for their advisory work.

The ruling overturned the previous understanding, and two lower court rulings, that relied on the Employee Retirement Income Security Act, which specifies a six-year limit to fiduciary liability. The Supreme Court reached back to trust law, which said that fiduciaries to a plan not only must exercise prudence in selecting investments but are "required to conduct a regular review of its investments, with the nature and timing of the review contingent on the circumstances."

The case, Tibble v. Edison, arose when participants in the Edison International 401(k) plan accused plan executives of breaching their fiduciary duties by including certain retail-priced mutual funds in the plan rather than institutionally priced versions of the same funds. Of the 40 funds offered by the plan, six were retail share class funds and thus were more costly than institutional shares.

SPONSORS 'have a continuing duty to monitor ... investments.'

Advisers must alert their business clients who have defined-contribution plans of the expanded obligations. In particular, the clients must consider the relative costs of the investment options offered in the plans and must choose the least expensive of equivalent options. They also must regularly review the investment options and replace any that don't seem to be performing.

Advisers also must be aware of their exposure if they provide assistance in selecting investment options. They might be held to the same standards as sponsors and trustees.

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Audit Bureau of Circulations

Latest twist on the annuity hits the market

Bloomberg News

They're having another go at turning your clients' retirement savings into an income stream that will last for the rest of their lives.

The problem is simple: You don't know how long your clients will live, so it's hard to know how fast they can afford to spend their nest egg.

When they retire, they can give their money to an insurance company, which will send them a monthly check for the rest of their lives. But annuities' fees can be high and their terms complex; moreover, many retirees don't want to tie up their money. The price of a dependable income into their 90s and beyond is the chance that they'll die younger and never get to enjoy it.

Last year, $229.4 billion in annuities were sold, the Insured Retirement Institute estimates. That's up 4% from 2013, but it's lower than sales in 2009 and earlier, even though the number of retirees keeps rising each year.

4%
Increase in annuity sales in 2014, to $229.4 billion

A generation of "managed payout funds" that launched in 2007 and 2008 was supposed to be the solution. But hardly any investors use them.

Now, Natixis Global Asset Management is launching a "retirement spending account" designed to deliver a predictable monthly check to retirees for life. As millions of baby boomers get ready to retire, there are signs that other fund companies and retirement plan providers also are working on new retirement income products.

MORE FLEXIBILITY

An investment account is more flexible than an annuity: If there's an emergency, you can sell it. If you die young, your heirs get the proceeds. But there's no guarantee it will last if you live longer than you expect.

Natixis addresses that uncertainty by adjusting its product's risk as investors get older. Because a market downturn early in retirement can really foul up your plans, the product's investments are conservative for the first years of retirement. By 15 years in, almost half the investments are in stocks, which are riskier than bonds but provide bigger returns. That should help the money last longer, said Edward Farrington, executive vice president of retirement at Natixis.

Then, as investors move through their 80s and 90s, the product turns more conservative again to preserve money for heirs.

Natixis investors can choose to receive either 4% or 5% of their accounts' assets each year in monthly checks adjusted annually for inflation. To get the 5% payout, though, investors need to take more risk, raising the odds that the money will run out in their later years.

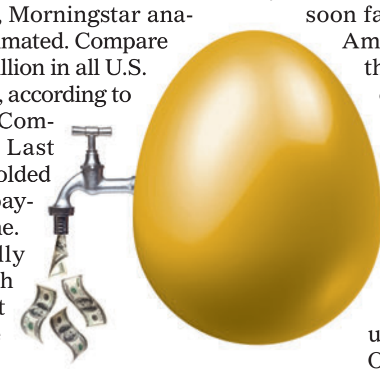
Another downside to the Natixis product is its fee of about 1% of assets per year. Because it is sold only through financial advisers, that's on top of any fees they charge.

Managed payout funds, an older effort to deliver retirement income, are simpler versions of the Natixis product. They don't adjust investment risk as you get older, but they provide a monthly income.

CHEAPER ALTERNATIVE

The largest, the Vanguard Managed Payout Fund, aims to give a 4% payout, with payments adjusted each year based on performance over the previous three years. It's cheaper than the Natixis fund, with a fee of 0.42% a year.

So far, managed payout funds have collected just $2 billion to $3 billion in assets, Morningstar analyst Jeff Holt estimated. Compare that to the $25 trillion in all U.S. retirement funds, according to the Investment Company Institute. Last year, Vanguard folded three different payout funds into one.



"They really didn't gain much traction," Mr. Holt said of the whole category.

It remains to be seen if the Natixis product, which went on sale May 15, can do much better. It may soon face new competition.

American Funds, the third-largest U.S. fund company, has filed paperwork to launch "retirement income portfolios" in three varieties, "conservative," "moderate" and "enhanced." Representatives didn't respond to requests for comment.

Others seem to be on the way, Mr. Holt said.

"A lot of fund managers are at the drawing board," he said, adding that, as of now, "there doesn't seem to be a clear answer."

One solution would be an easier way to mix investment funds and annuities. Retirees could get a guaranteed monthly check, along with a small fund for emergencies or inheritances.

Last year, regulators at the Treasury Department and the Labor Department made it easier for retirement plans to do this. They want 401(k)s to start including annuities that would pay a guaranteed income to workers when they retire. So far, no one has taken up the idea.

THE C-SUITE

MANAGEMENT INSIGHTS FROM PAUL REILLY

Listen and learn, yes, but be decisive

By Liz Skinner

PAUL REILLY'S management approach is as deep-rooted as they come.

The chief executive of Raymond James Financial is the third of eight children — and cultivated his listening and peacemaking skills growing up.

The talents have come in just as handy over the past two decades as he has helped giant companies through times of crisis.

Today, at 61, he still values listening, though he's learned to be a more deliberate leader.

Mr. Reilly knows his name will never adorn the brokerage that he took over five years ago from Tom James. But he's confident in his own mission to better the firm, which already boasts more than 6,300 financial advisers and $496 billion in client assets.

Mr. Reilly still wakes at night, though, wondering if he's doing enough.

TIMOTHY HEALY

LS: *Tell me about your leadership style.*
PR: It's pretty much a team, collaborative style. I'm a listener. I've come into three firms now with diverse cultures and I don't assume there's one way of doing things. Team decisions are usually better. The only two times I really veto are on strategy — we don't vary from it just because we feel like it — and anything against our core values.

LS: *Is listening a skill that you've had to develop?*
PR: I'm one of eight kids, that's an environment where you're used to listening and you're used to teamwork.

LS: *Do you think leadership is something that can be learned or is it an innate skill?*
PR: I think it's absolutely teachable, though people have innate qualities that make them better. You can teach someone basketball or tennis, but certainly the better athletes are going to do better at it. I have been taught leadership. There may have been some innate qualities that made me good at certain areas. You can teach how to listen, how to motivate, how to think; but certainly for those who do that innately, it's going to be easier.

LS: *What is the role of a leader in an organization?*
PR: It depends on the times. In times of stress, a period like 2009, or in crisis or in war, people want to be led. They want that comfort and solid feeling that they're going to be OK, and you're going to do things. You take a little more command and control in those times.

In most times, leadership is getting other people to lead. It's taking the roadblocks out of the way, enabling them to do what they should do. If I have 10 people reporting to me and I'm leading and making all the decisions, I can do a certain amount. But if I have 10 people making those decisions and executing, I've just multiplied my ability by 10 to have an impact on the organization.

> *"In times of stress, a period like 2009, or in crisis or in war, people want to be led."*

LS: *How do you encourage employees to deal with conflict?*
PR: You put it on the table. People sometimes think you can read their minds and you should automatically know what they're thinking. So you say that anything is OK to discuss and that it's OK to disagree. It's OK for two business heads to disagree, and then I'm the tiebreaker. What's not fine is not to bring it up. Debate is good because it comes out to a better answer.

LS: *Where do you fall short as a leader?*
PR: You can never overcommunicate in a professional services firm. And there's only so much time in a day. In my career, I've entered companies in tremendous downturns. I joined KPMG on Black Monday in 1987. I came to Korn/Ferry [International] in June 2001. Half their business was Internet-based recruiting, and you know what was happening then. I came to Raymond James in March 2009.

I think one of my real strengths is patience. Every one of these companies I've come into, people have expected me to make dramatic change, and I haven't. I watch and I assimilate and then I make an action. I think I make much better informed decisions.

But you can sometimes get too patient. If I have ever faulted myself, it's because I wanted smoother transitions. Maybe I didn't make the people changes as quickly as I should have, and when I made those changes, I looked back and said that I wish I had done those a year earlier.

LS: *What kind of culture are you trying to foster at Raymond James?*
PR: I came into 40-plus years of culture that was great, that fit completely into my values. I think Tom asked me to succeed him not because of my financial services experience but because of the values. The culture here is simple. It's trust, integrity and long-term conservative growth. We look long term, not short term, and the center of that is that clients come first. We do whatever is right for the client first, and we count the advisers as clients. There are tons of things that I could do to make more money, and our competitors do tons of them. But we don't do them because it doesn't fit us. It doesn't mean it's right or wrong.

LS: *Tell me about someone in your life who really influenced the man you are today.*
PR: There have been a series, starting with my dad and his values. He was a doctor, and what was right was always right. My first boss was great with people, he was a great marketer and a great explainer. Dick Jacobs, a lawyer, really taught me how to look under and beyond what you're being told.

When I joined Korn/Ferry, I knew it was in financial trouble, but I didn't realize it was on the edge of bankruptcy. After being there a few months I wondered if I could save the firm. I remember a call to the founder and I said, "Richard, I'm not sure I can save it." He let me talk, and then he said, "Well listen, son, people have given their lives to make this a great firm for 40 years; it deserves a leader. If you don't think you can lead, get out of the way. By the way, I think you're the right guy." He told me to think about it and call him in the morning.

I didn't sleep much that night, but I woke up a different person. He was right. There was a great brand, despite its financial difficulties. Leading in a crisis is about being in front, and I woke up on fire. I raised private equity, I paid off our defaulted debt. Years later we had no debt, had bought out the private equity, had a couple million dollars of cash in the bank and we were No. 1. Nothing had changed — we were the same firm, the same great people. It was me. Sometimes in crisis you really learn how to lead.

LS: *Do you feel like you've had that kind of an impact on people at the firms you've led?*
PR: I hope so. I think one of the hardest things for leaders to know is whether you are achieving enough. At KPMG, someone once asked me if I felt I was making a difference. I still wake up with that haunting question today. Am I really keeping this unbelievable asset of a firm with great values and great culture and making a difference, making it better? That's what you have to ask yourself as a leader, even in good markets.

Visit InvestmentNews.com/csuite for a longer version of this interview.

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Building retirement savings should be clients' top priority

Wharton's Marston suggests equity-heavy asset allocation

By Jeff Benjamin

Financial advisers need to encourage clients to make retirement their most important savings priority, ahead of college, recreation or any other goal.

That's the bottom line message from Richard Marston, a professor of finance at the University of Pennsylvania's Wharton School, who spoke last Tuesday at an Investment Management Consultants Association gathering in Detroit.

"The main objective of saving should be to build wealth for retirement," he said.

Once the savings foundation is established, Mr. Marston said the next steps include embracing an equity-heavy asset allocation, saving at least 15% of income and sticking to a 4% spending rule in retirement.

REBORN AS CIVIL SERVANTS

"Most people now have to fund their own retirement, although there are some lucky people who still have defined-benefit retirement plans," he said. "If we could be born again, we'd be born as government civil servants, where somebody else is going to pay our retirement for the rest of our lives."

Mr. Marston said financial advisers need to impress upon their clients the importance of delaying Social Security payments until 66.

"Retiring at 62 means your Social Security payments are 25% lower, but more importantly, you're cutting off four years of saving," he said. "I don't think you guys are getting that across to your clients."

On asset allocation, he said advisers should expose clients to 75% equities until they reach their early 50s, at which point the equity exposure should be gradually reduced to 50% by the time clients reach 66.

Mr. Marston supports an even larger allocation to equities during the prime savings years but said the key is to keep equity exposure low enough that investors aren't tempted to sell during a downturn.

"Choose an asset allocation not based on your feelings, because your feelings are much less relevant than your needs," he said. "The way to screw up a portfolio is to panic during a financial crisis, because the retirement portfolio will never be the same."

EURO COULD RALLY

Mr. Marston's model portfolio includes 25% in diversified bonds, 40% in domestic equities, 10% in emerging-market stocks, 15% in foreign developed-markets stocks and 10% in real estate.

Even though he recognizes the limits and recent underperformance of many of the global markets, he said diversification is key.

"The government finance problem in Europe is here to stay, and a case could be made that over the next 20 years, growth in Europe will not be as high as it has been," he said. "If they settle the Greek problem, the euro is not going to stay down, and I think it could really rally."

Mr. Marston said Japan is "over."

"We've known that for 25 years," he said. "Japan has an aging society and they don't want any foreigner to move there, but that doesn't mean we can't make money in Japan."

Regarding Bill Gross' declaration that the world is in a "new normal" of tepid economic growth, Mr. Marston said he would exempt America from that prediction.

"Longer-term, growth will slow down in industrial countries, but I'm not so sure that's the case for the United States," he said. "Just think about how much innovation we have here. We're going to have cheap energy indefinitely, and that's a huge boon."

Mr. Marston added that he is not worried about deflation, but he is worried about the "uncharted territory" of Federal Reserve policy.

"If I were on the Fed board, I would not have voted for [quantitative easing] 2 or 3," he said. "It has been an enormous help to investors to have interest rates this low, but it will cost taxpayers a lot of money if rates go back to normal levels, and that's scary."

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ISTOCK

Spotlight
Emerging Markets

INSIDE

MICHAEL MORGENSTERN

OPPORTUNITIES EMERGE

As the developed world limps along, advisers see better returns in smaller economies

By Trevor Hunnicutt

A slowdown in Chinese economic growth, a pullback in Indian stock prices and the Damoclean sword of U.S. monetary policy are hanging over emerging markets.

But that isn't stopping Chad White, president of Safe Harbor Wealth Management Inc., an LPL Financial affiliate in Toms River, N.J. Earlier this month the adviser moved a sizable chunk of his clients' portfolios from bonds to exchange-traded funds tracking stocks in Europe, China and India.

"This is the first change we've made" in a while, Mr. White said. "We didn't have any trades last year."

Investors this year have already poured $16.3 billion into mutual funds and ETFs tracking emerging markets stocks and bonds, as well as those tracking China and India specifically, according to Morningstar Inc.

On balance, those investors are finding bonds with plumper yields than their miserly counterparts in the developed world. They're also finding stocks that beat the 3.4% delivered by the S&P 500 so far this year, a tepid figure compared with the six-year bull market that regularly posted yearly gains topping 15%.

7%

Average return on diversified emerging-markets funds as of May 18. By contrast, the S&P 500 was up only 3.4%

Diversified emerging-markets funds are up an average 7% this year as of May 18, according to Morningstar. And emerging-market bond funds have paid an 81-basis-point premium over the intermediate-term bond funds favored by retail investors.

BETTER YIELDS ABROAD

"With continuing low U.S. investment-grade yields, investors have sought better yields in other countries, among other places, and emerging markets can serve that purpose," said Paul Christopher, head of international strategy at the Wells Fargo Investment Institute, a research group serving the San Francisco-based bank's 15,000 financial advisers, who manage $1.7 trillion. "They've been one of the destinations of choice. They've attracted a lot of flows."

Underneath the headline numbers, however, are countries taking divergent paths. For instance, after leaping 30% last year on hopes of business-friendly reforms, the India-tracking S&P BSE Sensex benchmark is down 2% so far this year, as of May 12.

Yet economic growth is now greater in India than in China, where a high-flying stock market seems, to some professional investors, inconsistent with the short-term prospects of the world's second-largest economy. The Shanghai Stock Exchange Composite index has returned a stratospheric 114% over the last year.

"It's a classic speculative bubble. But that speculative bubble has been given fuel by the easing policies in China," said Peter Taylor, senior investment manager on the global emerging-markets equity team at Aberdeen Asset Management, an Aberdeen, Scotland-based fund house that manages $491 billion.

China has cut benchmark interest rates three times in six months. But if U.S. growth ticks up, that may force

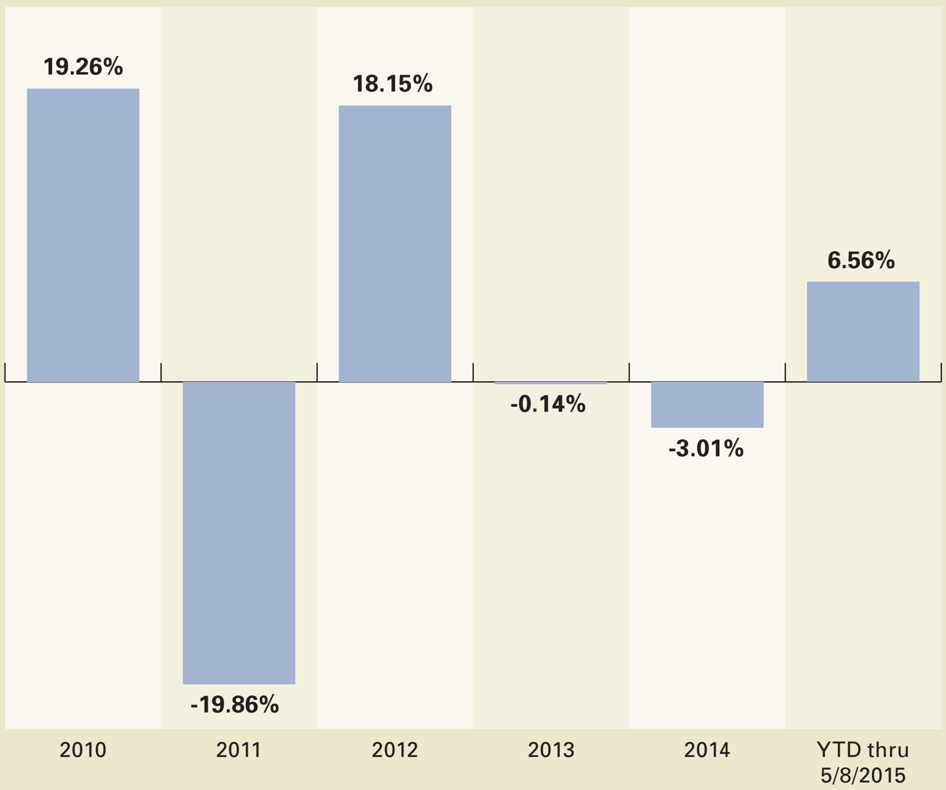
Continued on Page 14

Follow the money?

Investors have been putting less money into emerging markets amid choppy performance

As returns bounce around

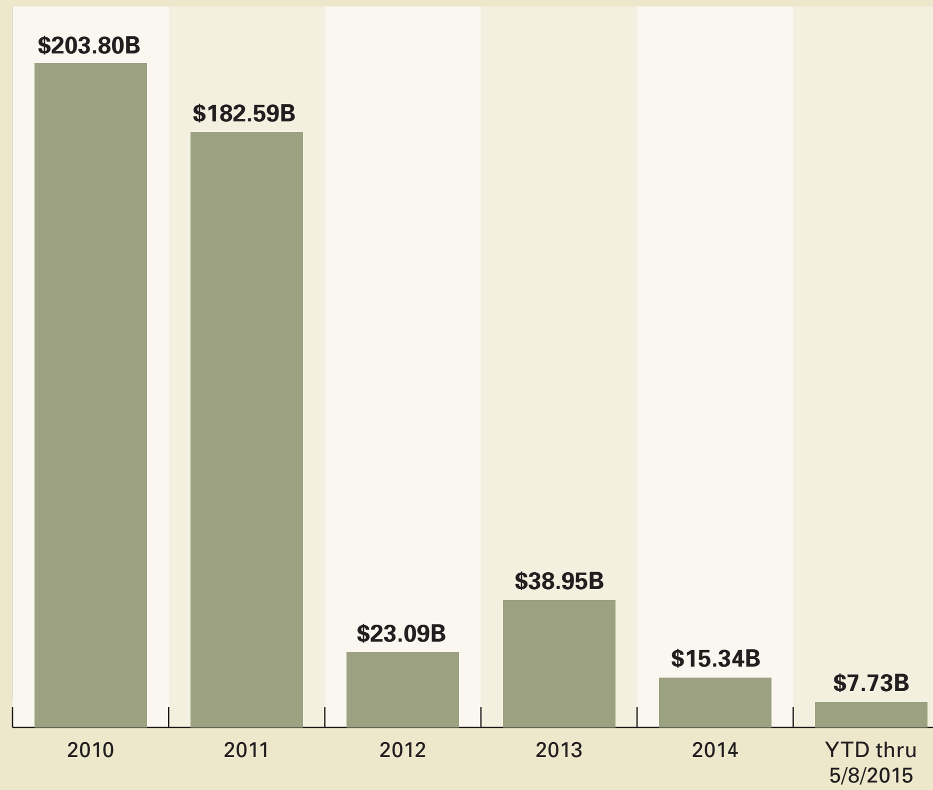
Percent return of diversified emerging markets portfolios



Source: Morningstar Inc.

... investors' love cools

Estimated net flows into diversified emerging markets portfolios



Source: Morningstar Inc.

Stock picking beats indexed exposure

Investing in specific companies is the best approach, but it entails more risk

By Jeff Benjamin

Investing in emerging-markets economies is less about why than about how and where.

Publicly traded companies in the emerging markets with a market capitalization of at least $300 million are represented by more than 6,000 stocks. That compares to 5,000 stocks in developed markets outside the U.S., and 3,000 domestic stocks above the same market cap. In terms of the total economic footprint, the 22 countries defined as emerging represent between 35% and 50% of the world's economic output.

With that in mind, Marcio Silveira, founder of Pavlov Financial Planning, has no trouble allocating 30% or more of his clients' portfolios to emerging markets.

"There are lots of economic reasons to expect consistent long-term outperformance from the emerging markets," he said. "And within the category, there is already so much embedded diversification, because the drivers of economies like Turkey and Mexico are very different from the drivers of economies like China and Russia."

A 30% allocation to emerging-markets stocks is probably beyond where most financial advisers are currently positioning their clients, especially considering the steady six-year rally in U.S. equities. But whatever the weighting, the case for investing in emerging economies is often an easy one to make.

FASTER GROWTH

"If you have a 10-, 15-, or 20-year horizon, it's difficult to say developed will grow faster than emerging markets," said Krishna Memani, chief investment offer at OppenheimerFunds.

Like a lot of emerging-markets specialists, Mr. Memani offers a nod toward broad market exposure through some of the popular indexing strategies, but says for more reliable exposure, stock picking is better. Overall, he said investors with time to do the research can't go wrong investing in economies associated with growth.

TYPICAL RISKS

Jonathan Brodsky, managing director at Advisory Research Inc., added that when investing in any emerging market, investors need to be aware of the typical risks, such as inflation, regulation, rule of law and politics. In essence, it is more than just a straightforward measurement of gross domestic product that gets factored in when defining and analyzing an emerging economy.

"An emerging market is a classification with a variety of different meanings," Mr. Brodsky said. "Some emerging markets are classified as emerging because of capital controls that make it more difficult for investors to trade there, such as places like Taiwan, South Korea, India and Brazil. Any visitor to Taiwan and South Korea would find it hard to distinguish between those markets and a developed market."

> *"It is about the companies, not the countries."*
>
> **Krishna Memani**
> OppenheimerFunds

While Mr. Silveira can be commended for taking his clients well beyond the bread-and-butter heavy allocation to domestic stocks that most U.S. investors have, he might be missing some of the emerging-markets advantage by sticking with broad indexed exposure.

Mr. Memani emphasized that the best way to take advantage of what happens in emerging economies is to focus on specific companies.

"With international in general, and the emerging markets in particular, it is about the companies, not the countries," he said. "I don't want to invest in China, I want to invest in the fastest-growing companies in China."

In other words, if you really want to tap into the growth potential of the world's emerging economies, you might need to step outside your comfort zone a bit and embrace the idea that growth often comes with volatility.

Marcio Silveira: No problem allocating 30% of client portfolios to emerging markets.

MORE VOLATILE

"The emerging markets are going to be more volatile than the average developed-market fund," said Todd Rosenbluth, director of mutual fund and ETF research at S&P Capital IQ. "The risk profile will be much greater, but we would encourage investors to embrace that and be prepared. But still look for funds that are less volatile than their peers."

For broad market exposure, Mr. Rosenbluth highlighted $33 billion iShares MSCI Emerging Markets ETF (EEM), which has an expense ratio of 68 basis points, and is up 9.1% this year through May 13. The $50 billion Vanguard FTSE Emerging Markets ETF (VWO), which does not include South Korea, costs just 15 basis points, and is up 10% this year.

Mr. Rosenbluth also noted, on the passive side, the $7.8 billion iShares Core MSCI Emerging Markets ETF (IEMG), which includes more small companies, costs 18 basis points, and is up 2.8% this year.

Even as he recognized the stock-picking advantages of actively managed funds in emerging economies, Mr. Rosenbluth flagged the significant hurdle imposed by the higher fees those funds carry.

The $8.9 billion T. Rowe Price Emerging Markets Stock Fund (PRMSX), for example, has an expense ratio of 1.2%, and is up 8.6% this year, compared with a category average of 6.2%. The $24.4 billion American Funds New World Fund (NEWFX) has an expense ratio of 1%, and is up 5.2% this year. And the $11 billion Virtus Emerging Markets Opportunities Fund (HEMZX), which has an expense ratio that matches the category average of 1.6%, is up 2.7% this year.

"In theory, the good thing is the active manager is going to take a look at broad emerging markets and be able to try and spot which regions and companies that are best-positioned," he said. "But when the average expense ratio for an active fund is 1.6%, the fund better be able to do well for that much money."

David Semple, head of emerging market equity at Van Eck Global, said it is an oversimplification to think of emerging markets investing only in the context of large and popular index strategies.

"The trouble is, emerging markets in many people's perception, is this amorphous block, but it is actually made up of several individual drivers," he said. "There are parts of the emerging markets where we see great opportunities, but just looking at it as indexes is a very skewed representation."

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Opportunities are emerging

Continued from Page 12

the Federal Reserve to raise rates aggressively, which could throw a monkey wrench in the works of emerging markets. Extremely easy monetary policy in the U.S. is seen as supporting countries dependent on foreign investment.

"The Fed could easily be the driver of the three- to six-month outlook" for emerging-markets stocks and bonds when they raise rates, according to Mr. Christopher.

But analysts caution that the impact of rising U.S. rates could be felt differently across emerging-markets countries — Brazil, Russia and Mexico, among them — that are more or less economically dependent on factors such as exports, commodity prices and the extent of state-controlled enterprises.

And despite the recent pickup in performance, emerging markets have a lot of lost ground to make up. Companies in those countries have delivered "virtually no earnings growth" over the last five years, according to Charles E. Knudsen, an equity portfolio specialist at T. Rowe Price Group Inc., which manages $773 billion.

OPPORTUNITIES IN INDIA

But many of the trends in the markets are positive, including government reforms and the fundamentals of some companies.

Mr. Knudsen and Mr. Taylor agree, for instance, that a number of Indian companies are exceptionally well-run. Both the Aberdeen Emerging Markets Fund (GEGAX) and the T. Rowe Price Emerging Markets Stock Fund (PRMSX) hold large stakes in India's Housing Development Finance Corp. and Infosys.

And they remain confident in the reformist agenda of Prime Minister Narendra Modi, who took office last year and is seen by foreign investors as slicing government red tape and investing in infrastructure.

Those factors are among the reasons keeping Mr. Knudsen optimistic about emerging markets, which he says are underrepresented in benchmarks and investor portfolios.

"There's been a little bit of a hiccup," Mr. Knudsen said. "We still believe in the long-term secular outlook," including the increased urbanization of their populations. "Growth in the emerging market will be faster than in developed markets."

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Debt market offers more than yield

Fixed-income securities are increasingly diverse and their credit quality has improved markedly

In the wake of the global financial crisis, financial advisers have been faced with the unenviable task of generating income and attractive returns for their clients in a world where yields on many fixed-income securities have been at or near historical lows, some even offering negative yields.

Financial advisers have, in many cases, grown more comfortable with "riskier" asset classes as they seek to find returns that satisfy their clients' needs. Emerging-markets debt, still a relatively new addition to the asset allocation toolbox of many advisers, is often lumped in with these. But such an all-encompassing view of EM debt fails to reflect the full range of opportunities offered by this growing and increasingly diverse asset class.

DOUBLED IN SIZE

The EM debt market has more than doubled in size since 2007 and at approximately $8 trillion exceeds both the $7.6 trillion global-investment-grade corporate-bond market and the $3.5 trillion global-high-yield bond market. The investible universe is composed of three sub-asset classes: sovereign hard-currency bonds, which are government securities, typically denominated in dollars or euros; local currency bonds — also government securities but denominated in a country's local currency — and corporate bonds, which are typically issued in dollars or euros by large domestic and multinational companies.

In addition to its impressive growth, the composition of the EM debt market has changed over time. Fifteen years ago, corporate issuance in emerging markets was a small fraction of the total hard-currency market as sovereign issuance dominated. While both have grown over that time, the size of the corporate market eclipsed the sovereign market in 2010 and hasn't looked back; today it is more than double the size of the sovereign market, and consists of many global powerhouses. Such names as Cemex, Teva Pharmaceuticals and Hutchison Whampoa headline today's EM debt market.

Guest Blog

Ricardo Adrogué   Brigitte Posch

Credit quality has improved markedly over time. For example, in 1998, over 90% of the emerging-markets sovereign universe was rated below investment grade; that number was less than 40% as of March 2015, according to Bank of America Merrill Lynch. In the corporate segment, the trend has been similar. Geographic diversity has also improved; for instance, the corporate market was once dominated by Latin American issues but is now split close to evenly between Latin America, Asia and Emerging Europe, Middle East and Africa.

INCREASED OPPORTUNITY

Perhaps the greatest impact of this market's development from an investment standpoint has been the increased opportunity set available for emerging-markets fund managers as they seek to construct portfolios for their clients. There are some obvious attractions for investors. The yield premium on offer is notable. At an index level, EM corporates were yielding over 5% as of April 30, with investment-grade names offering investors a spread of roughly 70 basis points over similarly rated U.S. debt. For high yield, that spread stood at 229 basis points. EM sovereign- and local-debt index yields, at roughly 6.4% and 5.4%, respectively, also look compelling in the context of low developed-market yields.

Diversification is another key benefit. As developed markets have continued to experience relatively sluggish economic growth, financial advisers have been hard-pressed to gain exposure for their clients to the higher growth economies in Asia, South America, Africa and other regions. With interest rate and economic cycles that vary from developed markets, investments in emerging markets can potentially offer low correlations with some of the asset classes that financial advisers typically manage on behalf of their clients.

The potential benefits do not come without risks. Emerging markets tend to be more susceptible to geopolitical risks and corporate governance issues. They also can be disproportionately affected by changes in currency values and interest rates. However, with the growth in size and diversity of the EM debt universe, it has become increasingly difficult to paint all emerging markets with one broad brush.

> **EMERGING** markets tend to be more susceptible to geopolitical risks and corporate governance issues.

IMPACT OF OIL PRICES

When oil prices fall, it certainly weighs on both EM oil companies, as well as the sovereign debt of oil-exporting countries. But the flip side is that oil-importing countries, of which there are many in the EM universe, receive an almost instant economic stimulus, as do corporate sectors tied to consumer spending. Similarly, as a rise in interest rates in some developed markets draws closer, the impact is unlikely to be identical for all emerging markets. For instance, countries such as Mexico are likely to benefit from higher economic growth in the U.S., and more broadly, many EM countries have floated their currencies in the past decade, making them potentially less susceptible to a stronger U.S. dollar and higher rates.

With such a broad and deep universe of country and company debt to invest in, it is increasingly difficult to sum up the prospects of all emerging markets with catch-all statements. Rather, success today in EM debt investing calls for rigorous credit analysis of both countries and companies in order to truly understand not only the risks, but also the opportunities.

Ricardo Adrogué is head of emerging-markets debt and Brigitte Posch is head of emerging-markets corporates for Babson Capital Management.

Movin' on up

Some countries are close to crossing the market threshold from frontier to emerging, which means more foreign investment. Saudi Arabia is the closest. While foreign investors have some opportunities to invest in China, much of that market remains closed. Here's a snapshot of markets that are opening up. — *Trevor Hunnicutt and Jeff Benjamin*

Saudi Arabia

Size: $561 billion market cap of stocks listed on the Saudi Stock Exchange

Potential: Global X Funds, Van Eck Global's Market Vectors and BlackRock Inc.'s iShares have filed with U.S. regulators to launch exchange-traded funds tracking the market.

Fast fact: The MSCI Saudi Arabia domestic index, with 43 companies, delivered 11% annualized over the five years that ended April 30.

China

Size: $5.5 trillion market cap of the Shanghai Stock Exchange

Potential: In 2014, seven China ETFs launched, from providers including KraneShares, Global X, Market Vectors, Deutsche X-trackers and PowerShares. Deutsche X-trackers Harvest CSI 300 China A-Shares ETF (ASHR) drew $1.2 billion in assets since its debut in November 2013.

Fast fact: Shanghai Stock Exchange Composite Index has returned a stratospheric 114% over the last year.

Bangladesh

Size: $175 billion economy with a per capita income of $1,190

The economy has grown by more than 6% in each of the past three years.

Potential: The eighth most populous country in the world with more than 160 million people, Bangladesh is viewed as the next source of cheap labor, which is the main catalyst for economic growth.

Fast fact: Garment exports, which totaled $18 billion last year, account for more than 80% of the country's total exports.

Estonia

Size: $7.1 billion market cap of the Baltic Regulated Market

Potential: Service sectors account for 71% of the Estonian GDP, industrial sectors account for 25% and agriculture accounts for approximately 4%. The economy is forecast to grow 2% to 3.5% a year.

Fast fact: Most people use e-banking, pay parking with a mobile phone and pay taxes and vote online. It is the home of Skype, Hotmail and KaZaA.

Washington state plugs retirement plans

By Mark Schoeff Jr.

A new law in the state of Washington aimed at expanding the number of workplace retirement plans adds momentum to states' efforts to get more of their citizens to start saving.

Last Monday, Washington Gov. Jay Inslee signed a bill that establishes a public website to match businesses with fewer than 100 workers to private-sector retirement plans. The Small Business Retirement Marketplace will be managed by the Washington Commerce Department, but the state will not offer its own retirement plan.

Washington is one of several states where legislation has been introduced or task forces have been launched to address the large portion of the population that lacks access to a retirement plan at work. Earlier this year, Illinois approved a bill that establishes a state-run automatic individual retirement account.

"The trend is for more and more states to take a look at state-based retirement initiatives," said Hank Kim, executive director and counsel at the National Conference on Public Employee Retirement Systems.

Retirement plan firms must offer a target date fund or something similar, as well as a balanced fund, to be included on the Washington website. The program also will involve the so-called myRA, a starter IRA being developed by the Obama administration.

OPTIONAL ALL AROUND

Signing up for retirement plans on the digital marketplace is optional for Washington small businesses, and joining them is optional for their employees.

"The marketplace will reduce barriers to information by educating small employers on plan availability," Bennett Kleinberg, vice president for institutional investment solutions at Prudential Retirement, said in a statement. "The bill addresses important reasons why small businesses don't currently offer plans by reducing administrative burdens and hassle, and limiting cost."

The Washington plan has drawn support from the broader financial industry, including the Securities Industry and Financial Markets Association. The bipartisan bill also was backed by the American Council of Life Insurers and AARP.

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Jay Inslee: Washington governor signed legislation setting up website.

Clients value relationship with adviser

By Srividya Kalyanaraman

It's not your advice, it's you that your clients value, according to a new survey by the Hartford Funds.

The survey of 500 investors who work with a financial adviser found only 32% of them valued financial performance more than a good personal relationship with their adviser.

Although most clients begin working with advisers to plan for retirement, only 47% of the investors in the age group of 45-64 felt as if their advisers gave them a clear picture of life after retirement.

"Because retirement is often the trigger for the relationship, it is alarming that more than half of respondents feel that advisers aren't talking to them about life in retirement," John Diehl, senior vice president of strategic markets at Hartford Funds, said in a statement. "Advisers need to find creative ways to continue the conversation about goals and the motivations for reaching them."

FILTERING INFORMATION

The traditional investment management-based adviser-client relationship has lost its usefulness in an age when people are bombarded with information and are looking for someone to help them filter out what is necessary to them.

"The emotional relationship between advisers and clients has never been more important than it is today," Mr. Diehl said. "We live in a time when information is at consumers' fingertips and it is the job of the adviser to quiet the noise.

"Advisers should not only be expected to deliver on quantitative performance, but also take a human-centric approach to advice by offering holistic financial counsel based on clients' individual goals and needs," he added.

"Clients are looking for more than just facts; they want to know the benefits and merits of investments," said Megan Yost, vice president and head of participant engagement at State Street Global Advisors. "Communication has become extremely relevant and technology is enabling big firms to take a step in this direction."

Supreme Court rejects Maryland double-tax structure

Advisers, accountants to file amended returns for county levies

By Darla Mercado

High-net-worth clients in Maryland are preparing to file amended tax returns after the U.S. Supreme Court found the Old Line State subjected residents to double taxes.

Last Monday, the Supreme Court arrived at a decision on Comptroller of the Treasury of Maryland v. Brian Wynne, voting 5-4 to uphold a state appeals court decision that found in favor of Mr. Wynne and declared Maryland's tax scheme, which assesses both state and county levies on income, unconstitutional.

The Washington Post estimates that about 55,000 taxpayers in Maryland could be affected by the decision.

Those who attempted to claim the credit on their county income tax returns from 2006 to 2014 may also be eligible for refunds, totaling an estimated $200 million with interest, according to the newspaper.

The case dates to 2006, when Mr. Wynne, a resident of Howard County, Md., owned stock in Maxim Healthcare Services Inc., an S corporation that did business in 39 states and filed state income tax returns in each of those jurisdictions.


ISTOCK

CREDIT CLAIMED

Mr. Wynne and his wife earned income that was passed through to them from the company, and on their 2006 tax return, they claimed a credit for income taxes paid to other states.

Generally, residents who pay income taxes to another state for income earned there are permitted a credit against Maryland's state tax, but not against the county tax. As a result, the state comptroller denied the Wynnes' claim and assessed a tax deficiency, according to the court. Maryland permitted a credit against the couple's state income taxes, but would not grant a credit against their county income taxes.

Other jurisdictions with similar tax structures include New York, where residents who pay taxes in other states can claim credit against their state income taxes, but not against the municipal income taxes levied by New York City and Yonkers, according to Bloomberg.

The disagreement kicked off a legal battle between the state of Maryland and the Wynnes. According to the Supreme Court's decision, the Hearings and Appeals Section of the Comptroller's office modified the assessment slightly, but affirmed the decision to grant a credit for state taxes and not county taxes.

The Circuit Court for Howard County reversed the decision, arguing that the state's tax system violated the Commerce Clause.

RISK OF MULTIPLE TAXATION

The Court of Appeals of Maryland affirmed the decision by the court in Howard County, finding that the county tax created the risk of multiple taxation and taxed interstate commerce at a higher rate than intrastate commerce. That court found the state's tax structure to be unconstitutional.

For many accountants and advisers in the state, the push to file amended returns is underway.

Lyle Benson, founder of Baltimore-based L.K. Benson & Co. and a CPA and personal financial specialist, said plenty of his high-net-worth and high-income clients are affected by the decision.

"They have interests in multiple states," he said. "They can be working in more than one state or have a partnership that generates income from multiple states. A number of them have real estate outside of Maryland."

The firm is readying a list of affected clients.

State income taxes in Maryland are as high as 5.75%, and adding county income taxes, which are capped at 3.2%, brings the total levy close to 9%.

"We've stressed for those with multiple state interests that the state income tax can be a huge piece of the puzzle," Mr. Benson said, noting that his firm is preparing to reach out to clients.

"We're just trying to sort out the process and what it will be," he said.

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Asset manager sees gold in grass; starts PE pot fund

By Jeff Benjamin

As marijuana becomes legalized in various parts of the country, investors and asset managers are grappling with the best way to make some money off the trend.

The latest, and perhaps most aggressive, effort is a new private-equity fund from Salveo Capital that will invest along the entire marijuana supply-and-distribution chain, including the businesses that physically handle the product.

Even though a growing number of states have relaxed laws and legalized use, marijuana is still illegal at the federal level, which has prevented earlier private-equity funds from venturing into exposure to companies that grow and sell it.

"We're going to be investing in legal marijuana, whether it is for medical or recreational use," said Alex Thiersch, Salveo managing principal.

> "THERE ARE a lot of wealthy investors who want to get into this industry."
>
> Alex Thiersch
> Managing principal
> Salveo Capital

HANDS-OFF APPROACH

"Growing, selling, researching and processing is all technically in violation of federal law, but the feds seem to be taking a hands-off approach," he added, justifying his push of the limits beyond just ancillary businesses that sell growing lights and soil-testing equipment.

Medical-use laws are on the books in 15 states, and marijuana is legal for adult recreational use in Alaska, Colorado and Washington, with at least a dozen more states expected to pass similar laws over the next five years.

From an investment perspective, the trend is difficult for some to resist.

"The [Salveo] strategy is viable," said Adam Bierman, co-founder of MedMen, a marijuana industry consulting firm.

"This is the next step of evolution of our industry, because access to capital is the single biggest issue, next to the lack of operational expertise," he added. "Direct investment in the space is the first iteration of this."

Skipping past, for now, the sticky issue of pot's still being illegal at the federal level, Mr. Thiersch believes he is tapping into the ideal model with his Salveo Fund 1, which began raising assets two months ago.

"There are a lot of wealthy investors who want to get into this industry, but there are also a lot of poorly run companies that aren't well capitalized and are dealing with

Continued on Page 23

Firm built on trust responds to the needs of its clients

By Liz Skinner

Lewis Altfest started Altfest Personal Wealth Management in 1983 with the goal of being a sort of Consumer Reports for financial planning.

He wasn't seeking to offer industry reviews, but he wanted to build a firm based on trust, where clients were confident the advice its professionals offered on investments and planning was straightforward and unbiased.

That mission remains paramount, said Karen Altfest, who is principal adviser of the New York firm Mr. Altfest still heads. She's also his wife.

"I love it when a client says, 'Nobody ever asked me that,'" Ms. Altfest said. "It shows that we're helping them think about new things."

A STEP AHEAD

The firm's professionals call clients to alert them to changes that may affect their planning, or with ideas in reaction to something that has occurred or will occur in the client's life, she said.

The firm keeps tabs on client service and satisfaction with periodic surveys and regular informal discussions. The feedback results in changes, such as creation of a new tax program after clients said they wanted more information on how their planning could affect their tax burdens.

"If you don't know what your clients think, you could live in your fool's paradise and think all is going along well, and it may not be," she said.

Dedicated client service and getting to know them at a deeply personal level has resulted in a steady stream of referrals that keep Altfest Personal Wealth Management growing. The firm has $1.2 billion in assets under management and about 600 clients.

Last October, Altfest Personal Wealth Management received an *InvestmentNews* Best Practices Award after being identified as one of the top performers among participants in the Financial Performance Study of Advisory Firms. Of the metrics studied, Altfest Personal Wealth Management ranked high in revenue per professional and pretax income per owner.

READY TO TRY NEW THINGS

The firm, which has teams of four to five people working with clients, also isn't afraid to try new things. Most recently, it deployed an open work environment in its new office.


Karen Altfest: Her firm works hard to understand what clients want.
ROARK JOHNSON

BEST PRACTICES

Altfest Personal Wealth Management
New York, N.Y.

AUM:	$1.2 billion
Revenue:	Not available
Clients:	600
Personnel:	28

The office is configured so that the firm's managers are in offices along the outside with large glass walls facing the inside of the office "so you can see what's going on," Ms. Altfest said. Pods are set up in the middle of the office where people who work together are clustered, and separate rooms are available for anyone who needs to have a private conversation.

The growing firm left behind office space with only two conference rooms because they seemed to be overbooked constantly. Now there are five meeting rooms of different sizes and configurations to meet everyone's needs.

GOOD PLACE TO WORK

In addition to caring for clients, the firm extends special attention to its employees. It recently introduced a new kind of flex-time for some people, allowing someone to take time off one day to attend a school event and make it up another time when they can, Ms. Altfest explained.

Altfest Personal Wealth Management also supports employees seeking designations, including the certified financial planner mark, and sends them to industry conferences throughout the year.

The firm's leaders are, at heart, planners, and they work hard to keep operations running smoothly, Ms. Altfest said.

"We may overthink a lot of things," she said. "But things happen when you plan well for them to happen."

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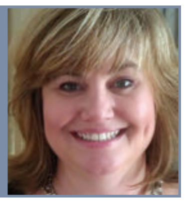
RETIREMENT WATCH
Carolyn Nees



Fun and games get clients involved

Engaging clients in their own retirement planning process gives them more control and input

Giving financial advice isn't fun and games. Money is serious business, and running out of it in retirement is among our clients' biggest concerns. However, as financial professionals, we sometimes take ourselves too seriously. As a result, we run the risk of coming across as too stern or authoritative, which can cause clients to resist our advice.

So when it comes to retirement planning, how can we engage clients in more playful, collaborative ways? Research from the MIT AgeLab suggests a technique called gamification can make a significant difference in how a client responds to the type of retirement planning advice we offer.

HOW IT WORKS

The principle of gamification recognizes that people are more apt to change their behavior when they are engaged in fun, achievement-oriented tasks with established rewards for positive action. This technique has been successfully used in customer loyalty programs, where consumers earn "points," in fitness and weight loss programs such as Weight Watchers and Fitocracy, and on travel sites like TripAdvisor, where you can earn a "review badge."

I recently put this technique to work in a personal way.

My widowed mother-in-law is a cute, 91-year-old from Nashville, Tenn., who recently started climbing out the bedroom windows of her (thankfully) first-floor condo at 2:30 in the morning. We were alerted to this strange behavior by several neighbors who were awakened by her knocking. It was not surprising that she was diagnosed with Alzheimer's disease.

Since it was no longer safe for her to live alone, my husband decided to take some time off to be her primary at-home (our home) caregiver until he could get her settled in a safe place that could serve her needs as her memory declines. He is learning what a hard job this can be.

"Here, Mom. Take your medicine."

"No."

"PLEASE take your medicine."

"Absolutely not."

"Ahhhrggg — take your medicine!!!"

"NOOOOOO!!!!!" With an occasional, sarcastic "thank you" in her sweet Southern drawl.

Her stubbornness is often met with his impatience, which is wearing down everyone involved.

Thankfully, we were given some great advice by the local Alzheimer's Association, a suggestion that parallels lessons from the MIT AgeLab research: Make it a game. Rather than sternly advising her to take her pills, we ask her to count her pills, make sure they are all there, then decide whether she wants to take the blue one now, or save it and take it last because it's her favorite color. By redirecting her attention and empowering her with choices, this seemingly daunting task becomes positive and fun. We are clear about the goal, don't make demands and give her back her sense of control over the choices she makes.

Too often, clients are not adequately planning for retirement because it seems too tedious and scary. Some clients can be stubborn, like my mother-in-law, not wanting to be told what to do. How often do we find ourselves trying to get our clients to take the "medicine" they need to attain financial wellness?

The concept of financial wellness takes into account choices and consequences. However, many clients just can't visualize their future well enough to understand the interplay of these concepts. That's where gamification exercises and goals-based planning software can help.

POSITIVE IMPACTS

Clients like to see the meter that shows how their choices affect their stated retirement goal, based on a number of inputs and assumptions. They like to see the positive impact of a higher savings rate. They don't like to see the impact of higher inflation. Clients want to win, meaning improve their chances of a comfortable retirement.

For archived columns, go to InvestmentNews.com/retirementwatch

Engaging clients in their own retirement planning process gives them more control and input and diminishes fear and indecision, as it did for my mother-in-law. It empowers them to choose and helps them pop down the pills, or retirement planning advice, you're offering.

Whether you're asking clients to write their retirement goals on index cards and then put the cards in order, or are using interactive retirement planning software, gamification is a great way to deliver a fun, interactive client experience that facilitates a more dynamic conversation and a deeper discovery process, which hopefully results in better retirement outcomes.

Carolyn Nees is a retirement solutions manager at Raymond James Financial Inc.

IRA ALERT
Ed Slott

Clarifying the once-per-year rollover

The new IRA rule, in effect since Jan. 1, seems to confuse advisers, if they're even aware it exists

Advisers are still not up to speed on the new, more strict interpretation of the once-per-year IRA rollover rule. It's been in effect since Jan. 1, yet advisers are still asking questions about it. Even worse, about 30% of advisers we have polled at adviser programs are unaware of the new rule.

Violating this rule has severe consequences that can lead to the loss of a client's IRA, or worse, lawsuits. At a recent seminar, an adviser asked if it was OK to accept two rollover checks (from two different IRAs) where the checks were made out to the client, personally. This is not OK, but the adviser had already done it. The client will owe taxes on the second attempted rollover and could owe the 6% excess contribution penalty as well.

Since the beginning of 2015, an individual can only do one 60-day IRA rollover in a 12-month period, per IRS Announcement 2014-32 (issued Nov. 10, 2014). The rule now applies to all of a client's IRAs in aggregate, rather than to each IRA separately (which had been the IRS position for many years). To be clear, this means that among all IRAs, SEP IRAs, Simple IRAs and Roth IRAs, only one rollover can occur every 12 months, not one rollover for each account or type of account.

DIRECT TRANSFERS

Unlike a rollover in which individuals personally receive a distribution from their IRA, direct (trustee-to-trustee) transfers between IRAs are not considered distributions and thus are not subject to the once-per-year limit.

For archived columns, go to InvestmentNews.com/iraalert

To be safe, always encourage clients to move IRA funds via direct transfers, even if it means waiting a little longer for the funds to be moved. The IRS also said that if the IRA owner receives a check made payable to the receiving IRA custodian, that check is treated as a direct transfer since the IRA owner doesn't have use of the money.

Here are answers to common adviser questions:

Question: I just discovered that one of my clients violated the once-per-year rule. Is there anything I can do to fix it, such as applying for an IRS waiver?

Answer: No. The IRS has no authority to allow exceptions to the rule, as it can for some late 60-day rollover situations. As a result, the subsequent rollover is not treated as a tax-free rollover, but instead, a taxable distribution. To make matters worse, the rollover is also treated as a regular IRA contribution, which often creates an excess IRA contribution in the receiving IRA, subject to a 6% penalty each year until it is corrected.

Question: Are there any exceptions to the once-per-year rule?

Answer: Yes. The exceptions are: Roth conversions done as a 60-day rollover from an IRA to a Roth IRA; IRA rollovers to and from company retirement plans such as 401(k)s; IRA first-time home buyer distributions when the home purchase is delayed or canceled; qualified reservist distributions that are repaid on time; and IRA-to-IRA or Roth IRA-to-Roth IRA direct transfers.

Question: Does the once-per-year rollover rule apply to Simple and SEP IRA distributions, or do they fall under the exception for rollovers to/from company plans?

Answer: Even though SEP IRAs and Simple IRAs must be established by an employer, for purposes of applying the once-per-year rollover rule, SEP IRAs and Simple IRAs are treated as IRAs, and are therefore subject to the rule.

Question: Does the new rule also apply to Roth IRAs?

Answer: Yes. It applies to all IRA-to-IRA rollovers and Roth IRA-to-Roth IRA rollovers.

Question: Is the 60-day rule still in effect?

Answer: Absolutely. Besides the once-per-year rule, an individual must still complete a rollover within 60 days after he receives the IRA distribution.

Question: My client has two IRAs at two different custodians that she inherited from her deceased husband as his only beneficiary. Can she roll them both over to an IRA in her own name (spousal rollover)?

Answer: The IRS has not directly addressed this issue, but to be safe, she should not move the funds using 60-day rollovers because it likely will be considered two rollovers within 365 days. Instead, she could do one as a 60-day rollover and the other as a transfer, or better yet, directly transfer them both.

Question: If a prospect did an IRA-to-IRA rollover in January 2015, when can he move his IRA funds to me?

Answer: Immediately. Simply have him directly transfer the funds to his IRA with you. There are no limits on the number of direct transfers that can be made.

Ed Slott, a certified public accountant, created the IRA Leadership Program and Ed Slott's Elite IRA Advisor Group. He can be reached at irahelp.com.

INVESTMENT STRATEGIES

William Scapell

Preferred securities seen as attractive

With yields of 6% and tax advantages, preferreds beat Treasuries and investment-grade bonds

With interest rates remaining low in recent months, many investors continue to struggle to find attractive sources of income. With yields of 6% or higher, generally high quality and potential tax advantages from the dividend income they pay, preferred securities are a compelling choice.

Preferred securities have characteristics of both stocks and bonds. Issuers are willing to pay much higher rates on them than they would on normal bonds because of the equity treatment that preferreds receive. Bank and insurance company regulators look at them as equity, and other issuers, such as utilities and real estate investment trusts, benefit from favorable treatment bestowed by ratings agencies. Yet from an investment standpoint, preferreds are much more like bonds than stocks.

Like bonds, preferreds are sold at par value, offer a fixed or a floating rate of income, and their prices fluctuate with changes in interest rates, or upgrades and downgrades to a company's credit rating. The dividends on these issues typically exceed what investors can get from a company's common stock or straight bonds. As with stocks and bonds, the income is taxable, but is often eligible for taxation at the favorable qualified dividend income rate — the same rate investors pay on long-term capital gains.

Even as preferreds' popularity has grown over the past few years, they remain a source of value compared with other income-oriented investments. They currently have a yield advantage of about 350 basis points over the 10-year Treasury, well above the 227 basis-point spread during the pre-crisis period spanning 1997 through 2007. Their yield spreads over investment-grade bonds also are currently high by historical standards.

PREFERREDS VS. HIGH-RISK

How do preferreds compare with high-yield bonds? While high-yield bonds have traditionally offered more income than investment-grade preferreds, the spread has been fairly tight over the past few years, remaining considerably below the historical average spread. Yields on the two groups even converged briefly.

This is more striking when put in the full context of credit risk. High-yield bond investors would need to go down five notches in credit quality before they would find yields comparable to those of investment-grade preferred securities.

Although preferreds are issued primarily by financial companies, they also are issued by nonfinancial issuers such as utilities and REITs. In addition, they come in a wide variety of structures that can help investors manage interest-rate risk.

Preferred securities are issued and traded in two distinct markets:

• $25 par preferred securities that trade on an exchange.

• $1,000 par preferred securities that trade over the counter. The security typical to the exchange-traded market is a callable fixed-rate issue with a long duration, hence high interest rate risk. This type of security is absent from the OTC market.

By contrast, the security types dominant in the OTC market are those structured as fixed-to-floating-rate securities that pay a fixed rate over an initial period, after which they can be called or reset to a floating rate — a feature that reduces their duration, or sensitivity to interest-rate risk.

A third type of security is a floating-rate security, which effectively has a near-zero duration because it resets frequently based on movements of a benchmark interest rate — with virtually no interest rate risk.

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MARKET ACCESS

Over the course of an interest rate cycle, it is critical to have access to both the exchange-traded and OTC markets, and all three security structures, with the understanding that some securities can perform much better than others depending on market conditions. For example, while OTC preferreds had good absolute returns in 2014, the longer-duration exchange-traded market did significantly better as bond yields declined. However, in 2013, a rising-rate environment, OTC preferreds fared much better.

As investors seek income in a low-rate environment, preferred securities continue to grow in popularity. Looking ahead, we believe that active management of credit and interest-rate risks will continue to be critical in coming quarters. Although the Federal Reserve may increase the overnight rate late in the year to diminish its extraordinarily accommodative stance, longer-term bond yields may be pinned down for the near term by low and falling inflation, as well as the strong dollar.

William Scapell is director of fixed income and a preferred securities portfolio manager at Cohen & Steers.

Supreme Court's decision on 401(k)s

ISTOCK

Continued from Page 3
to Jason C. Roberts, chief executive of the Pension Resource Institute.

Plan sponsors shouldn't just review the performance of the funds in the plan, but consider their fee policies and whether they're prudent and in accordance with the plan documents. Those items should be reviewed annually. "Share classes are such a hot item," Mr. Roberts said. "Plan sponsors need to look at that periodically and document that the share class, revenue sharing and allocation methods are fair."

Advisers and their firms, meanwhile, need to make sure their plan sponsor clients are aware that they themselves are giving the adviser direction on the universe of funds that can be chosen for the menu.

"We want to know what are the plan's objectives with respect to share class and revenue sharing," Mr. Roberts said. "Is the company paying the expenses to administer the plan? Are they paying for the plan minus revenue share? That question at the start of the investment policy statement helps rein in your liability."

This way, advisers know exactly what they're supposed to do, and plan sponsors have no misconceptions about their duties as plan fiduciaries.

GUIDANCE ONLY

"We want the plan sponsor to know that when it comes to administrative decisions about how the plan pays for services, [the adviser] can give you guidance but it's not a securities recommendation, and we're not recommending this fee policy over another," Mr. Roberts added. "But advisers can recommend funds that are congruent with that policy."

Marcia Wagner, managing director at The Wagner Law Group, notes that while the big question on everyone's mind is whether six years is enough for someone to be free of liability from a fiduciary breach, advisers should assume that they are never off the hook.

"You have to be looking in your lineup continuously," she said. "Basically, it means you have an ongoing duty to monitor, and it's hard to say that you have a statute of limitations argument."

Though now is a good time for employers to undergo a review of their benchmarks and processes, the timing of that review is still unclear, according to Michael Graham, an attorney with McDermott Will & Emery. He believes other plaintiffs' attorneys may try to tease that out.

"Is it annual, quarterly?" he asked. "There will be a lot of feeling out from the employers' perspective of matching costs and administrative issues with that duty versus how aggressive the plaintiffs' bar will be in raising new claims."

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Private-equity fund to invest in pot

Continued from Page 18

legal and regulatory issues," he said.

The fund, which requires a $250,000 minimum investment from accredited investors, is on track to have $10 million by the end of the month, and will be considered at full capacity when it has raised $25 million, according to Mr. Thiersch.

It is structured like a typical private-equity fund, which means there's a 2% management fee, a 20% performance fee and a 10-year investment commitment.

WAY TO ACCESS INDUSTRY

While the fees and long lock-up period might deter some financial advisers, the PE model could represent the best way to access the fledgling industry.

The fragmented marijuana industry is still made up mostly of small, mom-and-pop businesses. The few that have gone public have produced some wildly volatile stock-price performances.

Greengro Technologies Inc. (GRNH), which makes vertical growing systems, has a three-year annualized return of 47%, but it is down 79% over the past 12 months and 50% since the start of the year.

The company's total market capitalization is just $10.6 million.

The S&P 500 has posted an annualized gain of 19.4% over the past three-year period. It had a one-year gain of 15.8% and is up 3.9% since the start of the year.

GrowLife Inc. (PHOT), a maker of horticulture products related to marijuana growing, has given investors a similarly white-knuckle ride.

The $20.3 million company has a three-year annualized decline of 22.6%, a one-year decline of 79.6% and a 15.5% gain from the start of the year.

WILD RIDE

For a sense of the swings investors are seeing, GrowLife was up 114% in 2011, down 75% in 2012, up 308% in 2013, and down 86% last year.

Mr. Thiersch plans to smooth that kind of volatility by investing across the supply-and-demand spectrum, including ancillary businesses that provide testing tools and paraphernalia, and medical research businesses, as well as growers and sellers of marijuana.

"The companies we're looking at have an established market share and are expanding as the laws allow," he said.

> "IT WILL CREATE all kinds of unintended consequences or unintended opportunities."
>
> **Paul Schatz**
> President
> Heritage Capital

"When you think about the growth and size of alcohol or tobacco, or any pharmaceutical, imagine a market where you've got 10% to 20% of the population consuming cannabis, particularly if federal regulations loosen and we get interstate commerce," Mr. Thiersch said. "It's not unrealistic to think of some massive companies being created through consolidation."

In the meantime, it is a fund and a category for those comfortable dancing on the cutting edge.

If nothing else, funds like Salveo will test the powers and limits of regulatory oversight, and federal laws versus state laws.

"It's certainly pushing the envelope on what the states are deeming legal while it is still illegal federally," said Paul Schatz, president of Heritage Capital.

FEDERAL REGULATION

"When you get into raising money for an investment, you could bring in the SEC, which is federal oversight, so it's going to be fascinating to see how it shakes out," he added.

"I don't delve into the illiquid investments, but I'm going to watch this really closely, because it will create all kinds of unintended consequences or unintended opportunities."

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Robo-advisers assault your firm

Continued from Page 1
is just the start for robo-advisers. In some ways, low-cost investment advice is the Trojan horse to get investors — and financial advisers — comfortable with the idea of digital advice.

Behind the scenes, robo-advisers are quietly hatching plans to compete more aggressively with flesh-and-blood advisers. Wealthfront, the nation's biggest pure automated advice platform with $2.3 billion in assets, just hired the former design director from Facebook Inc. to help it better understand how design can help influence user behavior.

'PROFOUND IMPACT'

Robo-advisers are also pouring tens of million of dollars into developing mathematical formulas and behavioral maps to enable them to move into areas advisers have long considered immune to automation: retirement planning, trusts and estate planning and helping clients react to life's major emotional events.

"Robo-technologies are going to have a profound impact on the industry," said Elliot Weissbluth, founder of hybrid advisory firm HighTower Advisors. "They're going to dislodge and disintermediate unskilled and mediocre financial advisers."

And, if history is any guide, they'll do it at a fraction of what traditional advisers charge.

"There's a huge opportunity for us to do more," said Jon Stein, founder and chief executive of Betterment, a robo-adviser with $2 billion in assets. "We have a real lead [over other robo-advisers], and we have a more thoughtful road map because we are thinking about advice and planning as a very important part of the value that we can provide to advisers and our end client."

Financial advisers, for their part, are warming up to using automated investment platforms themselves. About 8% of top advisory firms — that is, firms that fall into the top quartile of RIA firms measured by overall revenue, assets under management and revenue per staff — now offer some sort of robo-advice, with another 20% expected to do so in the next two years, according to the soon-to-be-released 2015 Elite RIA Study by *InvestmentNews* Research in partnership with BlackRock.

These firms, according to the report, typically view robo-advisers as a way to attract younger, less-affluent clients, including the adult children of existing clients.

Robo-advisers are betting that clients' financial lives can be evaluated and analyzed in the same way actuaries incorporate risk and longevity into mathematical calculations. They're also betting that advances in technology will someday allow them to duplicate the experience of working with flesh-and-blood advisers.

'EVOLVE AND IMPROVE'

"In as little as two years, we're going to be blown away by the technology that just continues to evolve and improve," says Deborah Fox, chief executive and founder of Fox Financial Planning Network. "Most advisers who don't evolve their firms to leverage the new investment tech, as well as repricing within the next couple of years will, at best, have a hard time winning clients and, at worst, begin losing clients."

Traditional advisers could find themselves butting heads with a digital version of themselves sooner than expected.

Betterment, for example, just released its retirement planning software. The software, which was developed by a team of holistic financial planners and a Ph.D. in quantitative and behavioral finance, aims to ask questions that real-life advisers would ask of pre-retirees. Based on their answers, it calculates whether the investor is on track to meet his or her goals.

Eventually, the software could get into more detail, asking questions such as whether the prospect is a smoker, for instance, as it factors in longevity in retirement planning or considers life insurance recommendations.

More complicated tools — such as estate planning features — are still in beta testing, but are set to be rolled out in the next five years, according to Mr. Stein.

KAM TAI / ISTOCK

> "YOU'RE GOING to have a different experience, but you can do it all without an adviser."
>
> **Joe Duran**
> Founder
> United Capital

FutureAdvisor, another robo-platform with $600 million in assets, began offering free college savings plans and help transferring money to children, as a way to entice new customers to sign up for its platform.

Meanwhile, United Capital, a wealth management firm with about $14 billion in assets, is spending millions to develop software that will transform clients' answers into a comprehensive financial plan. All in less than 30 minutes and without speaking to a real-life adviser.

"You're going to have a different experience, but you can do it all without an adviser," said Joe Duran, the firm's founder.

The stakes for advisers are high.

At the end of 2014, assets held worldwide by robo-advisers totaled $14 billion, a small fraction of the total advice market. That figure, however, is expected to reach $255 billion in assets in just five years, according to a study from MyPrivateBanking.com.

If that sounds farfetched, consider that Financial Engines Advisors, which is widely viewed as the original robo-adviser for the way it automated retirement savings, has amassed about $100 billion since 1996, making it the nation's largest fee-only registered investment

Prepare for the 'robocalypse'

Deborah Fox, CEO and founder of Fox Financial Planning Network, came up with a list of tactics to build a "robo-shield" for your firm. Here are her top five:

- Become an expert at clearly articulating your value to prospects and clients by emphasizing all the human advice services you provide that a robo doesn't.
- Enhance the investment management services you provide by adding other areas of financial advice.
- Standardize and systematize your service pathways with customized workflows and checklists.
- Create a simpler service tier to fulfill both your clients' children's and grandchildren's (and other millennials') needs, as well as putting you in a position to retain the assets of your boomer and mature clients as they die.
- Partner with a robo-adviser that caters to advisers to better serve both your current clients and the next generation.

adviser, according to *InvestmentNews*' annual ranking of RIAs.

Big money is riding on the success of the robo-advice movement. Indeed, Betterment and Wealthfront have received a combined $235 million in backing from some of the same Silicon Valley venture capital firms behind Twitter Inc., Uber Technologies Inc. and Instagram.

CONSOLIDATION AHEAD

That money is going to come in handy. The early success of many robo-advisers in attracting assets, coupled with the fact that the barriers to entry in the automated advice arena are low, has brought many formidable competitors to the market. Well-established firms as Charles Schwab & Co. and Vanguard have recently launched robo offerings.

As a result, the industry is already ripe for consolidation.

"You're going to see five to 10 large national firms: United Capital, Wealthfront, Vanguard, Personal Capital, Betterment, [etc.], that will come from a different direction and end up in the same place," Mr. Duran said.

Firms that survive will do more than offer basic asset allocation services. They will likely offer long-term planning and advice through some combination of automation and flesh-and-blood advisers. That could mean full-time advisers for ultrawealthy clients, and call center advisers for everyone else.

George Kinder, long considered the father of holistic financial planning and the founder of the Kinder Institute of Life Planning, agrees that most investors will utilize both robo- and real-life advisers during the trajectory of their financial lives.

"Investors will go through a robo-adviser and use it as far as it can carry them," he said. "Then when they find technology issues, or personal issues, that don't feel resolved, that's when they'll search out who has the best qualifications and they'll go to them."

NOT A BE-ALL END-ALL

To be sure, robo-advisers are unlikely to put real-life financial advisers out of business. While robos may do a good job of asking questions that would determine whether an investor would benefit from long-term-care insurance, analyzing the various options for that insurance may be best left to a human, said David Cantor, head of practice management and consulting at Fidelity.

"There are certain things an automated service can do in terms of flagging issues, but then there's a lot of follow-up and implementation," Mr. Cantor said. "At least today, that's where there is a lot of value the adviser can provide."

It remains to be seen how today's robo-advisers will evolve over the next five to 10 years. One thing is certain, however: The services they offer will go far beyond helping clients invest in the markets.

Their ambitions are far greater than that.

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Sick of robo-talk? Get used to it

Automated advice movement is no fad; it's an opportunity

If you're like some of the advisers I talk to, you're sick of seeing headlines touting the latest robo enhancement, the new customers robos are targeting, the robo minimums (which are a lot lower than yours), the introduction of robo-based investment advice and how advisers "deserve" this competition for not pursuing a holistic financial planning approach. The list goes on and on, and I don't think it will stop anytime soon.

LANDSCAPE CHANGED

I see a gargantuan wave that will leave the landscape of the industry changed. Robo is not a fad, but an idea whose time has come. And although the increased prevalence of robo-advisers will surely be a threat to some traditional advisers, it's an opportunity for others who will capitalize on the technology to bring in additional assets under management, without a lot of extra work.

For example, those excited about the technological aspect of robo-advice see it as an avenue for capturing the attention of their clients' millennial children, who will inherit their parents' fortunes.

Others look forward to eliminating the necessity of pruning clients — a task most advisers hate — as they can transition C- and D-level clients to their own white-labeled robo.

Although boomers were not born with technology in their hands, they have been doing their best to embrace advancements in tech and take advantage of new systems and applications offered by their broker-dealers and software vendors. Your clients — young and old — are doing the same.

Still, for as many advisers who look forward to embracing robo ideas, many others continue to dismiss them because you can't shake hands with a robot, and you can't look a computer in the eye.

But hasn't another shift toward technology been happening in your practices? Many advisers report that at least some of their clients prefer to conduct business over the phone or via Skype.

As clients age, it is harder to get them to come to the office. Given the convenience for clients and the efficiency for advisers, it's not surprising that technology-supported review meetings are gaining in popularity. If this blip turns into a trend, it isn't much of a leap for clients to start working with a robo-adviser, engaging with a human adviser only occasionally. All of which means you need to get there before they do.

With all of the potential benefits inherent in the robo model, there is one big caveat: During a market meltdown, clients tend to need human contact ... desperately. Whether clients will remember those times when the option for reduced fees presents itself remains to be seen.

Still, there are a lot of reasons why you should keep your eye on the headlines and your practice ready to ride the wave that's ready to transform our industry.

Joni Youngwirth is managing principal of practice management at Commonwealth Financial Network.

TECH CONNECT

Verizon-AOL deal holds lessons for advisers

The telecom company has its sights on mobile, and so should you

By Alessandra Malito

Advisers can learn a thing or two from Verizon Inc., which is spending $4.4 billion to acquire AOL. It seems strange, given that AOL is known for its archaic dial-up system and the scratchy tone that comes with it, but Verizon saw value in the company.

Why? Because its sights are set on mobile.

This story might sound familiar to financial advisers, given that they have heard time and time again about the inevitability of a mobile-centric mentality. But the Verizon-AOL deal is yet another confirmation of the importance of mobile.

"It does make a great example for financial advisers," said Walter Lis, a digital marketing strategist who works with financial advisers, referring to the big deal. "The percentage of mobile traffic is increasing exponentially every month."

It's true.

In a memo to employees, AOL chairman and chief executive Tim Armstrong credited the rising mobile movement for the company's potential success. He said that in order to lead, the company would have to lead in mobile.

Investors have already caught on.

SMARTPHONE USE HIGH

According to a recent *InvestmentNews* research study on the future of advice, 82.5% of investors under 35 use smartphones to access their financial account information. For investors 35-44, that number is 71.9%. Tablets weren't too far off, with 51.7% of investors under 35 using them for financial account information and 48.1% of investors 35-44.

> "THE PHONE becomes a primary device to review things whenever you want."
>
> **Rich Ellinger**
> Founder
> Wealthminder

One way in which advisers can provide that personal, mobile experience is by offering portals where clients can view their portfolios and track their goals from their mobile devices.

"The phone becomes a primary device to review things whenever you want and in any environment you want," said Rich Ellinger, founder of Wealthminder, an online financial planning platform for advisers.

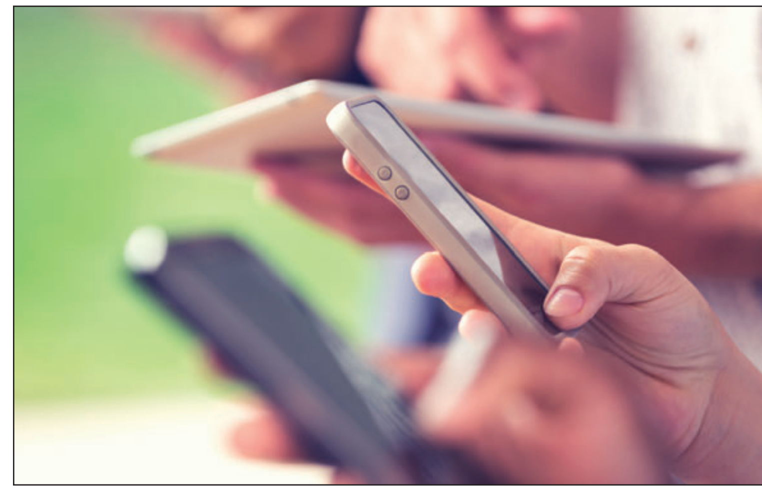
Mr. Ellinger said in the financial services industry, there's been a slower rate of growth in mobile, due in part to the average older-aged adviser. But mobile adoption isn't too far off.

"That will come with the next generation of advisers," he said.

The next step for Wealthminder, Mr. Ellinger added, is an app that will direct clients to its portal and provide push notifications about their accounts.

The benefits of using mobile devices are ease and efficiency. How quickly users can find a business on a search engine and then connect with those business owners usually determines how successful that company is at engaging with clients via mobile.

Google began its Get Your Business Online initiative this spring to promote local businesses by providing searchers with a quick Yellow Pages-styled entry at the top of the results.



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REGISTERING ON GOOGLE

When advisers register their businesses on Google for free, mobile users searching for the business will see contact information, business hours and a picture. Advisers can check if their businesses show up to mobile users with a Google test.

"Claiming your space on Google and allowing them to know who you are … so much is driven off of that, and a lot of that shows up in search results," Mr. Lis said.

That's how Tyler Gray, founder of SageOak Financial in Tulsa, Okla., gained two clients. They told him they had contacted him specifically because he had a mobile-friendly website.

Google recently switched its mobile search engine algorithm to weigh mobile-friendly websites more heavily in search results. Advisers can check if their websites are mobile-friendly with another Google website test.

"That's one thing about the adviser community I noticed when I made the transition to financial planning. It seems whatever everyone is doing today, the adviser community might get to it in five to 10 years," Mr. Gray said. "If we're lucky."

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How top performers use technology

Strategic use helps unlock time to provide non-investment advice

With recent rapid advances in technology, clients now have access to investment apps on their phones that are on par with any wirehouse workstation. So, faced with a clientele increasingly comfortable with technology, how do top-performing financial advisers utilize tech compared with low-quintile producers?

"They think more strategically about technology than lower-quintile performers," said Joel Bruckenstein, a technology consultant and financial adviser.

Advisers are facing a technology tipping point. Nearly 80% of high-net-worth clients under 40 say they would leave a firm that did not integrate technology into customer services such as online access and mobile apps, according to the 2015 *InvestmentNews* Adviser Technology Study.

ADVISERS TAKING THE HINT

Advisers are taking the hint, with 59% saying they are likely to increase their technology spending this year, the study also showed. Client satisfaction was a major goal, according to the survey.

While consumers have access to better technology than ever before, Mr. Bruckenstein said that's not the end game.

"I'm not sure that they're always able to interpret the research the same way that professionals can," he said. "Secondly, there's a behavioral bias, which I think is one of the biggest problems that investors face. And technology is not going to solve that, or it hasn't to this point."

Besides, Mr. Bruckenstein believes that investment management is not the most important thing an adviser does.

"I would argue that most of the value that advisers provide is not on the investment side, it's on the wealth management and financial planning side of things."

FILLING A NEED

This is where new automated investing services are filling a need for advisers — providing automation for investment management and creating more time and space for these other issues. They are also solving behavioral issues, such as the impact of changing allocation because of emotions rather than as a strategy.

Mr. Bruckenstein believes that some advisers are not as educated as they should be about robo-advisers — or choose to ignore them.

Andrew McFadden, a 31-year-old adviser and founder of Panoramic Financial Advice in Clovis, Calif., agrees that technology is providing a solution for the technical aspects of investment management and creating more room for other advisory activities.

"It's putting more weight on us as advisers to deliver advice outside of the investment realm," he said. "For insurance, estate planning and taxes, and all those other financial decisions."

OFFERING ROBOS TO CLIENTS

Mr. McFadden also recommends robo-adviser platforms to some of his clients — and he's not alone. In the *InvestmentNews* study, 6% of advisers say they currently offer robo-portfolio services — and 12% said they would be doing so in the near future.

Cost efficiency and portfolio allocations that are guided by experts are two reasons Mr. McFadden recommends robos. He feels confident that his clients are getting a sophisticated level of expertise at a low cost. He said it helps clients who are just starting out to get good investment advice without having to meet high minimum balance requirements.

And he doesn't see these online investment services as a threat. By being paid an ongoing retainer, Mr. McFadden can assist clients in financial planning matters without actively managing their portfolio.

Ultimately, the financial planning process is about much more than technology, Mr. McFadden added. "People don't care how much you know until they know how much you care."

Hal M. Bundrick is a contributor for Betterment Institutional, a former adviser and senior investment specialist for Wall Street firms.

GERARDO TABONES/ISTOCK

Plan to ask more on ADV

Continued from Page 3
think the industry is largely supportive of that kind of effort to modernize the reporting forms," said Mr. Grohowski, who attended the SEC open meeting.

The public will have 60 days to comment on the proposals after they are published in the Federal Register.

ADDITIONAL RISK REPORTING

In another proposal released last Wednesday, the commission would require additional data from investment funds about their use of derivatives, securities lending activities, pricing of portfolio instruments and use of exchange-traded funds. They would have to disclose basic risk metrics and improve how they send data to shareholders.

The changes are designed to upgrade the SEC's reporting requirements to reflect increasingly sophisticated securities markets. They are part of an initiative Ms. White outlined in December to help the SEC better monitor potential systemic market risks posed by fund portfolios and operations.

"They will make the asset management industry stronger and more resilient, improving the ability of funds to manage their risks and — critically — the commission's ability to supervise funds and investment advisers," Ms. White said.

SEC member Luis Aguilar said both the markets and regulators would benefit from the proposals.

"Ultimately, greater access to high quality, useful information fosters confidence in investment decisions and in regulatory actions and initiatives," he said.

The proposals also help strengthen the SEC's position as the primary regulator of the asset management industry, said SEC member Daniel Gallagher Jr. The Financial Stability Oversight Council also is delving into the systemic risks posed by the sector, a move that is causing tension between banking and securities regulators.

"The SEC is more than up to the task," Mr. Gallagher said.

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Rubio's retirement account

Continued from Page 3
for household appliance upgrades.

"It sounds like he's in a cash crunch," said Wes Shannon, owner of SJK Financial Planning. "That's because he hasn't planned well enough to have some emergency funds."

IN A POSITION TO RECOVER

Advisers cut him some slack, however, saying he is in a better position than most people to recover. And his need to fund a presidential campaign could pay off, even if he doesn't capture the White House.

> "MAKING POOR decisions and then asking the public to trust you ... is not well thought-out."
>
> **Wes Shannon**
> Owner
> SJK Financial Planning

"He's going to have income opportunities whether he succeeds in his presidential bid or not," Mr. Chen said. "That's different from most Americans who would have to rely on that 401(k) for retirement."

Indeed, if he falls short of the presidency, Mr. Rubio likely could write another book — his current one is doing well, he says — or, after his Senate service, hit the paid-speaking circuit.

"Marco Rubio's calculation is: Who needs retirement money?" Mr. Auslander said. "All you have to do is hire a really good speaking agent."

Although his case may be unique, Mr. Rubio is not setting a good example for other Americans, Mr. Shannon said.

"Making poor decisions and then asking the public to trust you to make good decisions as a president is at least not well thought-out," Mr. Shannon said.

But withdrawing money early from a retirement account positions Mr. Rubio as relatable to the many cash-strapped Americans making similar tough financial decisions — setting himself apart from likely Democratic nominee Hillary Rodham Clinton and likely Republican challenger Jeb Bush, who are both wealthy.

"It shows he's not the moneyed elite, which is a positive," said David Schneider, owner of Schneider Wealth Strategies. "It shows he's a regular guy."

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Social Security's 'minor' $12.4M mistake

Continued from Page 4
pay the beneficiary the difference between their monthly benefit and the GPO amount.

The GPO rule affects federal workers employed before 1984 who participated in the Civil Service Retirement System, which was not subject to FICA payroll taxes. It also affects state employees, including some public school teachers, in Alaska, California, Colorado, Connecticut, Illinois, Louisiana, Maine, Massachusetts, Missouri, Ohio, Nevada and Texas.

> **438K**
> Spousal beneficiaries who don't get benefits because of GPO

SSA PROCEDURE

The GPO rule only affects a portion of Social Security beneficiaries. Although more than 6 million people received Social Security spousal and survivor benefits in 2014, SSA said only 438,000 spousal beneficiaries did not receive a monthly benefit amount because of GPO.

For beneficiaries who are subject to GPO reductions, SSA is supposed to record their pension start date, monthly pension amount, offset amount and date of any expected pension increases on the Master Beneficiary Record.

When SSA increases a spouse's monthly benefit amount because of a cost-of-living adjustment, it produces an alert for individuals whose benefits SSA has suspended because of the GPO. To resolve this alert, SSA employees must verify the current pension amount, update the Master Beneficiary Record pension and GPO amounts and pay any benefit due.

The inspector general chose 100 beneficiaries as a random sample. For 87 of the beneficiaries in the sample, the report said SSA had not verified or updated the Master Beneficiary Record for an average of 15.8 years.

When the inspector general obtained cost of living increases from the pension paying agencies to determine their current pension and GPO amount, it found that 12 of the 87 beneficiaries were underpaid $139,803 because SSA withheld an excess GPO amount; one was overpaid $19,609 because SSA under withheld GPO; and 74 were properly paid but their pension and GPO amounts listed on the Master Beneficiary Record were incorrect.

"Generally, these errors occurred because SSA employees had not resolved alerts that required they verify and update the Master Beneficiary Record with current pension and GPO amounts," the report found. "SSA needs to improve its controls to identify and pay spousal beneficiaries who have an excess withholding of GPO," the report concluded.

The Social Security Administration agreed with the report and promised to update pension amounts as necessary and establish applicable overpayments and underpayments.

In the meantime, what should you do if you are concerned that you or your clients might be affected by outdated GPO estimates?

"If you have questions about how your Social Security benefits are impacted by GPO, please visit your local office and ask to speak with a representative," Social Security spokesman William Jarrett said.

(Questions about Social Security? Find the answers in my ebook available at InvestmentNews.com/MBFebook.com.)

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Wagner urges 'war' on fiduciary

Continued from Page 2

One approach is to build grassroots opposition. Another is to pass a bill Ms. Wagner has written that would force the DOL to halt its effort until the Securities and Exchange Commission decides whether to pursue its own fiduciary rule for retail investment advice.

TARGET FUNDING

A third method would be to target DOL during the congressional appropriations process later in the year.

"If push comes to shove … by God, we'll just defund them," Ms. Wagner said to cheers from NAIFA members.

Before that stage, Ms. Wagner said she hopes opposition to the rule will force Mr. Obama to back down. She hopes his reversal on curbing the tax advantages of 529 college savings earlier this year can be repeated.

"We sure watched the president do an about-face on the 529s when the people spoke," she said in an interview after her appearance at the NAIFA event.

Her bill likely will get a hearing in the House Financial Services Committee in June, said Ms. Wagner, who is a member of the panel. She said she has Democratic cosponsors who have not yet been announced.

> "WE ARE AT WAR with the Department of Labor … If push comes to shove … by God, we'll just defund them."
>
> **Rep. Ann Wagner**
> Missouri

"They're not ready to be outed," she said.

Opponents of the bill say it is designed to kill the DOL rule because the SEC may never decide to move ahead with its own fiduciary rule.

A version of the measure was approved by the House in October 2013, and Mr. Obama threatened a veto. It's unclear when the current bill would get a House vote or what its prospects are in the Senate.

Ms. Wagner said she has spoken to Senate Banking Committee Chairman Richard Shelby, R-Ala., about the fiduciary rule, but not about her bill.

"I do believe we have support over in the Senate," she said.

In her NAIFA speech, Ms. Wagner said brokers and insurance salespeople had been unfairly portrayed by proponents of the DOL fiduciary rule, including Mr. Obama and Sen. Elizabeth Warren, D-Mass.

"You all, despite what this administration and Sen. Elizabeth Warren think, are not snake-oil salesmen," Ms. Wagner said. "It's amazing how you all have been villainized. You all are family to the customers you serve."

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Puerto Rico case costs UBS $1M

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would be "indicative of how other panels may rule," according to the statement.

Arbitration awards do not set legal precedent, but Mr. Rosado's attorney, Harold Vicente-Gonzalez, who said he is representing around 150 investors in similar claims, explained that he felt the panel's logic behind why it granted damages would apply to many of the other claimants.

"Most of our clients are in this same position," said Mr. Vicente-Gonzalez. "This does have an impact on the whole situation."

Last week, another panel ordered UBS to pay $200,000 to an investor who the firm claimed only had $8,000 in out of pocket losses, according to the attorney in the case, W. Scott Greco. The client had asked for between $400,000 and $700,000 in damages.

NO RATIONALE

Arbitrators in that case did not provide a detailed rationale behind their decision.

In a third case, an arbitrator denied claims from an investor who represented herself and asked for around $10,000 related to damages from investments in the UBS Puerto Rico Fixed Income III Fund.

"Claimant had experience investing in a similar fund, and was provided with a full explanation of the nature and risks of the investment," the arbitrator wrote.

"Therefore, the arbitrator determined that the investment was suitable for claimant when made," the arbitrator wrote.

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Gundlach rips go-anywhere guys

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bond category, which includes unconstrained funds and other strategies, is up 1.4% this year through last Tuesday. Twenty-nine such funds have been launched in the U.S. over the past year.

Investors have turned against the category, pulling $2.4 billion from the offerings this year through April 30 after adding $78.7 billion over the two previous years, according to Morningstar.

TREND WON'T LAST

That trend won't last, according to Rick Rieder, chief investment officer for fundamental fixed income at BlackRock Inc. and a manager of the firm's Strategic Income Opportunities Fund (BASIX). The fund gained 5.2% over five years, far ahead of its benchmark and competitors.

"Unconstrained is going to keep growing and growing because there's a limited supply of fixed income," Mr. Rieder said. But he said managers in the space often trade one risk — that rising interest rates will erode bond prices — for credit risk.

"The moniker is wrong because what unconstrained allows you to do is take less risk," said Mr. Rieder. "We'll use negative duration. We'll use it in places where we think it makes sense and particularly when you get a bang for your buck quickly."

Matt Cody, chair of the asset allocation committee at Wetherby Asset Management, said his financial advisory firm uses unconstrained funds only in exceptional circumstances. He said his firm would prefer to control its portfolio duration itself and employ specialist managers as needed.

> "UNCONSTRAINED IS going to keep growing and growing because there's a limited supply of fixed income."
>
> **Rick Rieder**
> BlackRock Inc.

"In the marketing materials they send out, it shows it's low risk because it's low duration, but what happens if there's an equity selloff, a flight to quality?" said Mr. Cody. "What they tend to do is sell the equities and high-yield bonds and buy Treasuries." Such a move would imperil the trade designed to achieve negative duration.

MANAGER'S OWN FUND UP

Mr. Gundlach's own offering in the category — the DoubleLine Flexible Income Fund (DFLEX) — has climbed 2.8% this year through last Tuesday, beating the Barclays U.S. Aggregate Bond Index, a widely watched benchmark that has returned 0.3% over the same period.

The fund has taken significant stakes in emerging-market debt, collateralized loan obligations and residential mortgage-backed securities, as well as junk bonds. DoubleLine says many of those securities are largely less sensitive to rates.

DoubleLine also correctly read the January rally in Treasuries as a sign of a bear market to come, Mr. Gundlach said. That's when the yield on the benchmark 10-year U.S. Treasury note began its bounce from a low of 1.64% on Jan. 30 to a high of 2.29% last Wednesday. Yields move inversely to prices.

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ISTOCK

SEC rap against firm

By Mark Schoeff Jr.

The Securities and Exchange Commission charged an Atlanta investment advisory firm with violating suitability rules by putting pension funds for city workers into inappropriate alternative investments associated with the firm.

The SEC alleged that Gray Financial Group improperly sold investments in GrayCo Alternative Partners II LP to four Atlanta public pension funds for firefighters, police officers, city employees and transit workers.

The agency asserted that the investment advisory firm's chief executive, Laurence O. Gray, and co-chief executive, Robert C. Hubbard IV, recommended the investments even though they violated provisions of a state law that governs how public pensions and retirement systems can invest in alternative funds.

For instance, the law says a public pension's stake in an alternative fund cannot represent more than 20% of the fund's capital. In addition, a pension cannot invest in a fund that has less than $100 million in assets, and cannot enter a fund that does not have at least four other investors.

The SEC alleged that the Gray Financial officials told the Atlanta pension funds that the investments were consistent with Georgia law, even though they did not meet the criteria outlined under the measure.

"The claims and arguments in the SEC's filing today are without merit," Terry Weiss, a partner at Greenberg Traurig and a lawyer for Gray Financial, as well as Mr. Gray and Mr. Hubbard, said in a statement. He also asserted that the SEC is trying to stymie the firm's suit over hearing venues. An SEC spokesman did not respond to a request for comment.

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All-in with new alts fund

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to right before the 2008 financial crisis and another gut-wrenching correction, he is now 70 and holding a $2.49 million portfolio.

The annualized return of 5.8% is only a hair better than the 5.7% annualized return of a portfolio invested in 60% stocks and 40% bonds over the same period. The difference would have been a slightly less volatile ride, which might have been enough to keep the investor from running to the sidelines.

Take that same ride on the AlphaCore model, which, admittedly, is back-tested, and the annualized return is 7.6%, pushing the total portfolio to $3.3 million.

KEY DIFFERENCE

The key difference can be found in the first market pullback after the tech bubble burst in 2000.

At the end of 2002, the AlphaCore portfolio was at $1.2 million, while both the all-stock and the 60/40 portfolios had shrunk to $780,000.

"That's the real key to including alternatives," Mr. Pfister said. "You lower risk and make more by losing less."

From that base at the end of 2002, the AlphaCore portfolio would have grown to $2.4 million by the end of 2007, while the all-stock portfolio reached $1.4 million, and the 60/40 portfolio reached $1.6 million.

The big drop from the financial crisis, which bottomed in March 2009, pushed the AlphaCore portfolio down to $1.8 million, but the all-stock portfolio slumped to $757,000, and the 60/40 portfolio hit $1.1 million.

The core of the portfolio, which is designed to be a static allocation, includes managed futures, global macro, event driven, multistrategy and relative value funds.

The rest of the portfolio is high-yield and global core bonds, emerging-markets stocks, real estate and commodities, as well as both public and private long/short equity.

Note that some of what Mr. Pfister calls traditional — including commodities, real estate and long/short equity — are often considered alternative strategies. With that in mind, it could be argued that the portfolio is actually closer to 60% allocated to alternative investments.

That clearly will not sit well with a lot of financial advisers, but it will be interesting to see what tune they're singing after the market corrects.

Thomas Meyer, CEO of Meyer Capital Group, and a proponent of using alternative strategies, said he tops out at a 25% allocation to nontraditional assets. "If [Mr. Pfister] would have had that [AlphaCore] allocation over the past six years, he would have severely underperformed," Mr. Meyer said.

That's probably true, but as Mr. Pfister pointed out, the focus on alternatives right now is more about defense than offense.

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