Tarheel Advisors Newsletter

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What is a Fiduciary?

The word “fiduciary” comes from the Latin root *fidere,* which means to trust. According to the dictionary, the term refers to any situation in which one person justifiably places confidence and trust in someone else and seeks that person's help or advice in some matter. Although we typically associate it with a monetary transaction, another common instance would be the attorney-client relationship, where the attorney is expected to act in the best interest of the client at all times.

You may ask, why am I being loquacious with a somewhat obscure word only used by the verbose? The reason is things are about to change big-time in the financial services arena, and this word is about to take center stage. Six years in the making, new rules spawning from much of the Dodd-Frank legislation are about to come into force in April of 2017. These rules will, for the first time, force financial advisors to do what’s best for their clients!

When you put it that way it almost sounds laughable — as in why don’t they have to do this in the first place?

*2010 Study by Cerulli & Associates

The truth of the matter is many financial professionals have long been held to what is known as the “suitability” standard as opposed to a fiduciary level of care. FINRA, the governing body for brokers, puts it this way: *When your broker recommends that you buy or sell a particular security, your broker must have a reasonable basis for believing that the recommendation is suitable for you. In making this assessment, your broker must consider your income and net worth, investment objectives, risk tolerance, and other security holdings.* What is noticeably absent from this description is anything regarding fees and commissions. The suitability standard has long been a proxy for non-disclosure of conflicts of interest and hidden expenses. Thankfully, this will change for the better in regard to some areas often abused by the unscrupulous.

The main areas affected deal with retirement accounts: both individual and group sponsored. The Department of Labor (DOL) will begin to require a “fiduciary” standard by any person —whether they be a broker, registered investment advisor, or insurance agent — paid to give advice to a plan sponsor, plan participant, or even an IRA owner. These new rules will eliminate some bad practices and make it easier for investors to make a successful legal claim against adviser malfeasance.

The biggest downside is that brokers still won’t be required to exercise fiduciary care on all types of accounts (taxable brokerage accounts are excluded), and there is a long implementation timeline that could allow for some pushback. Firms will be required to acknowledge their fiduciary status by April 2017, and they have until January 2018 to comply with the rules.

Now that you know what is happening, you’re probably asking what is the main takeaway and what is Tarheel Advisors doing about it?

As a Registered Investment Advisor, our firm has always been held to a fiduciary standard on all our advice. We believe that doing things in the client’s best interest should be second nature and not something you need imposed on you by a new law. As Certified Financial Planners, Ryan and I have long been held to this standard even before we started this firm in 2009 and will continue to try and be proactive rather than reactive to changes in our industry.

With that in mind, I recently sought out the opportunity to grow my knowledge in this arena and bring some new best practices to the way we interact and invest for clients. Accordingly, I had the privilege to learn from the Center for Fiduciary Studies through an online course and a boot camp in Charlotte. After passing the comprehensive exam, I’ve added a new credential, the Accredited Investment Fiduciary (AIF), and more importantly I’ve become better educated in prudent practices that will help our clients.

-**Walter Hinson, CFP®, AIF®**

2016 Market Update

S&P 500	**+7.74%**
DOW	**+5.07%**
RUSS 2000	**+10.19%**
MSCI World	**+3.18%**
BONDS	**+5.80%**
GOLD	**+23.83%**

Mortgage Rates

15-Year	**2.66%**
30-Year	**3.47%**
5/1 ARM	**2.94%**

Did You Know?

* Since 1928, the stock market has signaled which Presidential candidate will win 19 out of 22 times. When stocks are higher months before the vote the sitting party has won 86% of the time.

* You can now book review meetings with us on our website.

* For more information on the AIF designation or fiduciary best practices, please visit http://www.fi360.com

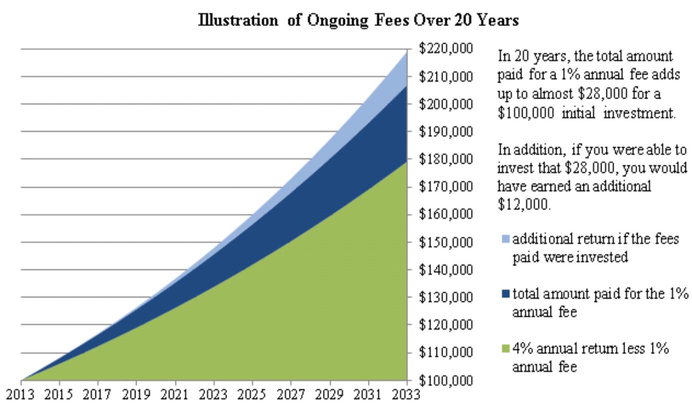
The Value of an Investment "Fee"duciary

I started my career in 2002 working at Scottrade: The home of the $7 stock trade. Scottrade and many other discount online brokers make their living providing do-it-yourself investors a platform to manage their own money and do so at a reasonable cost. For my first couple of years in the business I wondered why any investor would pay money to a financial advisor when it was so easy to do-it-yourself online.

Then, after a while I figured it out…. You see, when you work at a discount brokerage you get to see just about every investment strategy you could imagine. I saw investors try day-trading, long-term investing, penny stocks, and options just to name a few, and I'd estimate about 80% of the clients we had made significant portfolio mistakes, and about 50% of them implemented strategies that most likely lost them money over the long term. It was a frustrating thing to see, but because I wasn't working in a fiduciary capacity I was disallowed from ever helping clients fix their mistakes.

Most people agree there is value to a financial advisor (otherwise our business wouldn't exist), but what exactly is that value? I wondered this over the summer as well, so we examined around 50 of the largest independent registered investment advisors in the state to see what they were charging clients at different asset levels. We have posted the findings on our website (www.tarheeladvisors.com/fees.html). For $250k accounts the average fee was 1%. That fee dropped to 0.84% for $1M accounts, 0.75% for 2.5M accounts, and 0.64% at the $5M threshold.

We've seen fee compression in our industry for the past decade or so, and I'd estimate advisory fees have come down around 30-50% over the last ten years. So, where do investment advisory fees go from here?



There is probably a bit more room for fee compression in the industry, but in my opinion advisory fees are now getting to a point where they are fair and reasonable. Vanguard (the Mecca of do-it-yourself investors) recently did a study that highlighted the value of professional investment advice. They concluded a value of as much as 3.0% annually in increased performance. Below are the highlights of their study:

Being an effective behavioral coach. *Helping clients maintain a long-term perspective and a disciplined approach is arguably one of the most important elements of financial advice. (Potential value add: up to 1.50%.)*

Applying an asset location strategy. *The allocation of assets between taxable and tax-advantaged accounts is one tool an advisor can employ that can add value each year. (Potential value add: from 0% to 0.75%.)*

Employing cost-effective investments. *This critical component of every advisor's tool kit is based on simple math: Gross return less costs equals net return. (Potential value add: up to 0.45%.)*

Maintaining the proper allocation through rebalancing. *Over time, as its investments produce various returns, a portfolio will likely drift from its target allocation. An advisor can add value by ensuring the portfolio's risk/return characteristics stay consistent with a client's preferences. (Potential value add: up to 0.35%.)*

Implementing a spending strategy. *As the retiree population grows, an advisor can help clients make important decisions about how to spend from their portfolios. (Potential value add: up to 0.70%.)*

You'll notice that none of the reasons for hiring a financial advisor include "beating the markets". Interestingly enough, this is what most people think is our primary job function, but for most financial professionals this isn't the primary way we create value for the client.

When it comes to your own money and investments, probably the hardest thing of all is to be objective and unemotional. A great financial advisor earns their money by being an objective resource for the client. -**Ryan Glover, CFP®**

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