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A FAMILY OFFICE

VIEWS FROM THE BRICK

PROTECT YA NECK

Trust issues. The pitfall to any relationship. Your relationship with your advisor is no different. You've entered a relationship with someone, or a team of individuals, who are qualified to help you reach your financial goals. You've done your best to vet your advisor as the right option: a credible person with a depth of knowledge, someone with the time and ability to bring to the table what you need and expect in a relationship. You determined your advisor passed your suitability test. A word that is a bigger deal when you get into the nitty gritty of the investment industry. Here's another word investors should familiarize themselves with: *fiduciary*. The same way you determined your advisor was suitable for you, they typically determine if an investment is suitable for your situation. But that doesn't necessarily mean they're acting in your best interest. In fact, if they're not a fiduciary, then they're not required to. Which begs the question, is your advisor really an advisor?

SUITABILITY STANDARD VS FIDUCIARY RULE

If you're being thrown for a loop, don't worry the finance industry (and government) seems to have made this far more complicated than it ever needed to be. It's no wonder why the reputation of Wall Street is what it is.

The suitability standard is something that brokers and many "financial advisors" have had to operate under until this point. The standard claims that an investment recommendation by a broker must satisfy suitability obligations pertaining to reasonable basis, customer specificity and quantitative suitability. Some traditional boxes that are checked when this decision is being made are age, other investments, time horizon and investment experience. Does this investment make sense for the beneficiary and their portfolio? That's just about the extent of the standard in layman's terms. Trillions of dollars in assets and thousands of individuals are subject to this criteria.

The graduation of the suitability standard is the fiduciary rule. Fiduciaries are investment professionals who subscribe to the highest legal, and ethical duty to a beneficiary party. Suitability is part of this practice, but the fiduciary rule states that all fiduciaries must act in the best interest of an investor when making a decision. Always. All of the time. The biggest way this separates a fiduciary from the rest of the pack: fiduciaries cannot profit from their investment recommendation, and in the majority of relationships, they can not profit from anything other than fees paid by the investor; unless explicit consent is granted in the immediate conversations after an investor swipes right on an investment advisor.

WHO'S WHO?

Chances are nobody introduced themselves to you as a fiduciary when you began your relationship. Generally speaking though, most fiduciaries (who are often independent Registered Investment Advisors, more on this in a second) will reference a fiduciary duty they adhere to. But the financial services industry is dominated by a handful of household names that many investors gravitate toward. The problem is, these investors are drawn in by a name of a company, not to the individual who becomes their financial advisor.

These institutions are extraordinarily important pillars to the global economy. And their leaders, for the most part, are individuals who excel in their role and are well-aware of the responsibilities bestowed upon them.

But that doesn't change the structure of their business, and as broker dealers, they are in the business of executing transactions on behalf of investors (broker) and on behalf of themselves (dealer). Primary income for these institutions is generated by commissions earned from making transactions for the investor. By definition of the fiduciary rule we just outlined, they don't qualify. This should raise the question: if your advisor is associated with a broker dealer, why?

Then there's the high-cost mutual fund share classes these financial advisors seem to chronically place their clients in. For those who are not up to date on mutual fund distribution, here's a table that outlines the costs associated with these different offerings.

	Class A	Class B	Class C	Class I
Front-End Load	Initial Sales Charge Can be reduced or eliminated by breakpoint discounts.	None.	Generally None.	Generally None.
Contingent Dererred Sales Charge	None.	Declines over several years.	A lower CDSC than Class B and eliminated after one year.	None.
12b-1 Fees	Typically, lower than Class B and C Shares.	Typically, higher than Class A.	Typically, higher than Class A.	None.
Converts to A Shares	N/A	Converts to A shares after several years, thereafter reducing expenses.	Generally no. Annual expenses remain at Class C level.	No.

Multiple share classes and multiple cost structures (some of which should be illegal in our opinion) for the same investment strategy. Where do investors who allow these individuals onto their team find themselves placed more often than not? We'll give you a hint, it's not the option that makes the least amount of money for the broker and keeps the most amount of money in the clients' portfolio. We really don't need to call Sherlock and Watson to figure out why these funds (and the investors in them) routinely underperform benchmarks. Who can succeed when they have 2, 3 or 4% shaved off their investment from the jump? The ones who do the shaving, of course. A study by the White House Council of Economic Advisors in 2015 estimated that American investors could be losing $17 billion a year as a result of advisors and brokers recommending mutual funds and other products with relatively high costs, with hidden incentives being offered to those recommending those investments[1].

MISLEADING COVERAGE

Every year, numerous financial publications will release their "top advisors" for a given year. Among the most notable lists is the Barron's Top Advisor Rankings. This list was released in March for 2018. Barron's aggregates the top 1,200 advisors in the United States and numerically ranks them. The list

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even splits the ranking up by state. Why 1,200 is the magic number, maybe nobody knows. But how the list is calculated is public information, and lucky for you we're pretty good at addition and division.

According to Barron's, their lists are calculated and ranked by assets under management (AUM), revenue generated by advisors and the quality of service they provide. That last point is qualitative and we're not going to get into a subjective debate. But the first two are quantitative and might sound harmless. As for the AUM metric, you're instantly creating a size bias on the list which then brings up the argument of quality service. But what we want to hone in on is the revenue generated by the advisor. The revenue generated by an individual advisor for their respective firm will be driven by fees and commissions. All advisors, fiduciaries or not, will be generating revenues by fees. Preferably, an investor should be in a relationship with an advisor who operates under a fee-based business model. But given Barron's calculation (and the table highlighted above), you're going to be hard-pressed to see too many advisors on their list not associated with a broker dealer; and therefore, not too many individuals who are proper fiduciaries. Thanks to some simple arithmetic, you won't have to wonder too hard just how many exactly. (You're welcome.)

We took a quick look at some states with sizeable investment management industries on this list, Florida, New York and California. After going through the 324 advisors across these states, we were able to identify 87%[2] of the names as being associated with a broker dealer. We don't extrapolate often, but we're going to imagine that this number might be pretty close to the representation of the list as a whole. So are these top advisor lists that get published really just lists of top sales people?

Other reports paint an even bleaker picture for investors. A study conducted at the Wharton School of Business at the University of Pennsylvania estimates of the ~285,000 professional advisors in the U.S., fewer than 2% are fee-only advisor who adhere to the fiduciary rule[3]. The rest? Well the remaining 98% are brokers or registered broker-advisory firms that are able to take commissions on products recommended to clients. If the financial advisor industry appears to be dominated by individuals and institutions who do not legally have to act in the best interest of the people they represent, what other choice do investors have?

RISE OF THE RIA

A strengthening transition within the industry has seen Registered Investment Advisory firms continue to gain market share over the last 15 years[4]. These firms range in services from wealth management, family office services and asset managers. The growth in AUM for these RIA divisions was 5.8% in 2017, reaching $70T[5]. Over a three-year period ending 2015, RIAs saw their assets grow at a compounded rate of 12%. Multi-family offices led the way with a 13% growth rate[6]. Investors continue to hear about the difference in service between RIAs and registered professionals who work with major broker dealers and wire houses. What are they learning?

The services provided by these investment professionals are bound to the fiduciary rule for starters. That means whatever investment solution (fund or security) that's being brought to the table does not carry a hidden commission or fee that makes its way back to the investment advisor. It also means the investment recommendation is being made, or action is being taken, with the impact to the beneficiary in all respects being kept at the forefront.

These RIAs not associated with broker dealers also means there is not a playbook being pushed from the top. Without the connection to a larger institution, the investment solutions selected for the investor are likely coming from an open architecture and platform. Often times you'll find investment portfolios presented by the financial advisors (FA) associated with broker dealers nearly filled with funds and

SOURCE: This presentation is solely for informational purposes and should not be taken as investment advice. For further information, please contact one of our investment adviser representatives. [2] Barron's. [3]WSJ [4]Charles Schwab. [5]NRS & Investment Advisor Association. [6]Cerulli Associates research.

strategies run and branded by the associated firm. Do the majority of your conversations you have with your FA revolve around them having a new fund for you to purchase? It's not completely their fault; they've probably been handed orders for cross-selling quotas. But we certainly wouldn't constitute that as investment advice.

We encourage all investors to be painstakingly selective with whom they associate themselves when planning for their future. Being aware of these differences within the industry is a good place to start, and an even better place to reevaluate who you've allowed into your circle. Just because someone can call themselves a financial advisor, doesn't mean they're on your team. It's like Robert Fitzgerald Diggs told us, "Yo, you best protect ya neck."