STRATEGIC PORTFOLIO BALANCE℠

Issue 60 **Investment Discipline** 2015.05.08

This is our client communication newsletter and it is researched, written and distributed by:

BellinghamFinancialPlanners.com

Ronald Scott Colson, CFP®, MBA, President

Colson Financial Group, Inc., Registered Investment Advisor

28 years of excellence! We serve our clients with:

- *Fee-only financial planning (zero sales bias);*
- *Fee-based investment management (zero commissions);*
- *Less than 1% is invested in stocks of fossil fuel companies; and,*
- *Fiduciary services (keeping your best interests foremost).*

4740 Austin Court, Bellingham WA 98229-2659

US/Canada Toll Free: 800.530.3884 Office: 303.986.9977

Web Site: http://www.ColsonFinancial.com/ *eMail:* Ronald@ColsonFinancial.com

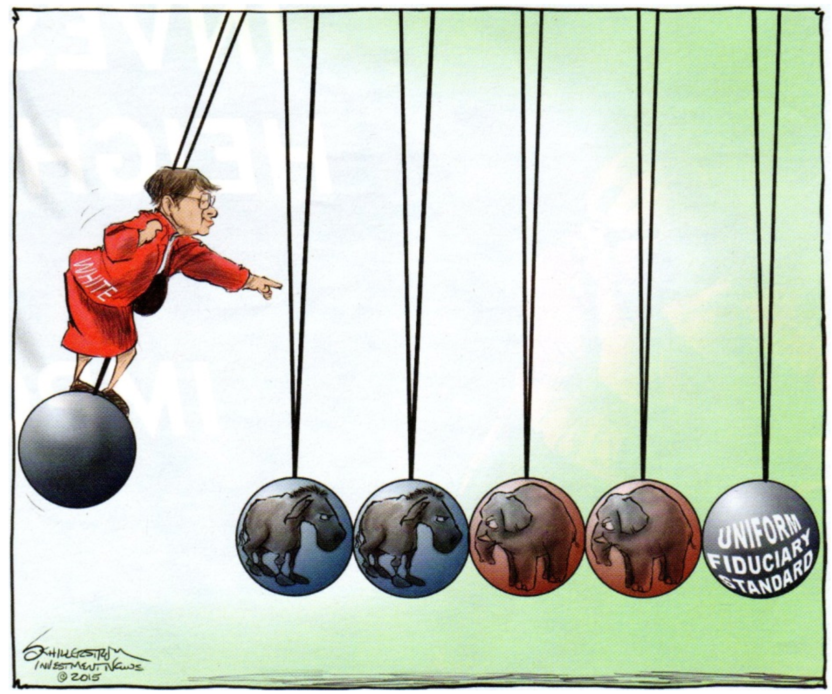
IN THIS ISSUE **PAGE**

Fiduciary Standard v. Suitability Standard

For over a decade, debate has raged within my industry regarding the need for full disclosure to clients of any potential biases in the investment advice being given to them by their investment advisors. On my side of the fence (fee-only Registered Investment Advisors) we must adhere to the very strict "Fiduciary Standard." On the commission-sales side of the fence (broker-dealers and their registered representatives) they must jump over a much lower bar known as the "Suitability Standard." Most consumers are not aware that there are stark differences between the two standards or even that any standards exist in the first place. Instead, most clients assume that their insurance guy or their wire-house broker is always looking out for them more than for himself, a misunderstanding that the broker-dealers are loathe to correct.

The Dodd-Frank Act is legislation that was passed into law in 2010 was an

attempt to reform Wall Street to avoid a repeat of the 2008 meltdown. One small part of that Act was intended to untangle the misunderstandings that the public has about the potential for bias in the investment advice that they receive. As a first step toward fully implementing the law we are close to having new and stricter requirements placed on anyone who provides investment advice to ERISA-qualified retirement plans such as your 401k, 457 or 403b plans offered through your employer. But the portion of the Act that pertains to providing investment advice to individuals has not yet been implemented. (It hasn't even been written yet!) This delay is the direct result of the fierce opposition to it by the well-heeled broker-dealer lobby. First let's examine the differences between these two standards.



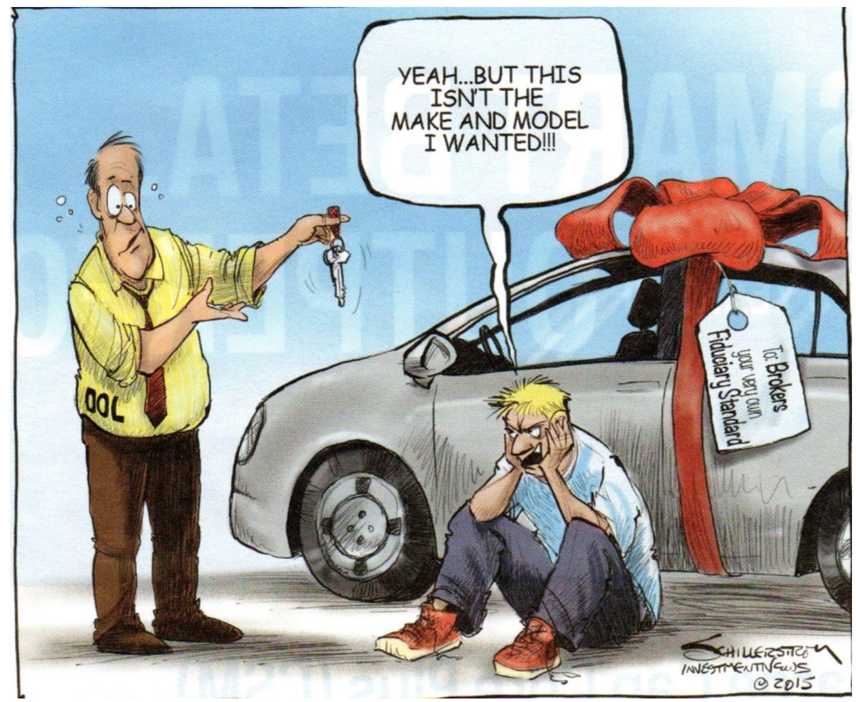
The Fiduciary Standard – The Investment Advisors Act of 1940 requires fee-only Registered Investment Advisors (like me) to always place our clients' best interests ahead of our own. Our loyalty is to our clients. If numerous similar investments are available, we must always recommend those that are the best available for clients even if the advisor earns less (or no) money in the process. Further, we are required to itemize all sources and amounts of compensation in writing. We must fully disclose any potential conflicts of interest, such as being an owner of the company whose securities we are recommending. We must always buy or sell securities for our own investment accounts at the same time and at the same price that we are buying or selling those same securities for our clients' accounts. That requirement prevents "front-running" wherein the advisor gleans most of his profits before clients have any opportunity to profit for themselves. We are not allowed to sell securities to our clients from our own investment accounts and we are not allowed to sell any security to a client that is owned by another client. All buys and sells must be executed through an independent security exchange, preventing any potential for price manipulation. Finally, Registered Investment Advisors are regulated by the U.S. Securities Exchange Commission and/or each of the separate states' Divisions of Securities where investment advice is offered by the advisor.

The Suitability Standard – Broker-dealers (and their registered representatives) are not subject to the Investment Advisors Act of 1940. They function under an entirely different set of rules that have been written by themselves and are administered by their own self-regulatory agency known as "FINRA." FINRA performs examinations of broker-dealers and their registered representatives without any governmental oversight. Since the broker-dealers write and enforce their own rules, this arrangement has the potential to appear like the "fox guarding the chickens!" Brokers are only required to make investment recommendations that are "consistent with the best interest of the customer." That is code for being allowed to sell their broker-dealer's higher-cost, potentially lower-performing proprietary products that pay higher commissions, as long as the products being recommended are not blatantly "unsuitable" for the client. Broker compensation is not required to be disclosed to clients. Many of the securities being recommended to clients are actually owned by the broker-dealer and then subsequently sold directly to clients, not through an independent exchange. (If it's such a great investment, why are they unloading it in the first place?) But the key difference between the two standards is loyalty. Registered representatives owe their loyalty to their broker-dealer, not to their clients!

At first blush, one might think that my explanations imply that I believe all registered representatives of broker-dealers are essentially crooks trying to swindle their clients. But the reality is exactly the opposite! Most registered representatives with whom I interface are extremely honest, sufficiently knowledgeable and most are truly committed to faithfully serving their clients. Further, because of the more lucrative compensation scheme that is available to registered representatives when advising smaller-sized accounts, they can afford to devote more of their time to giving advice to clients who don't have much money to invest. This commission-based compensation scheme has always acted to serve a much larger segment of the investing public that is basically ignored by fee-only Registered Investment Advisors who must maintain higher volumes to remain profitable. Also, not all proprietary broker-sold products are inferior. In fact, I have utilized some of them myself (but only institutional class shares instead of commissioned shares). However, the inherent bias of the advice that may be given by registered representatives becomes clearly evident when one considers that there can be significant limitations on the number and types of investment products that have been approved for sale by their broker-

dealer in the first place. Additionally, broker-dealer sales incentives (like "free" trips to Hawaii for their top producing registered representatives) have the potential to skew the advice given to clients.

Now back to the Dodd-Frank Act. Since the vast majority of the investing public assumes that the job description of fee-only Registered Investment Advisors is interchangeable with that of registered representatives of broker-dealers, the Dodd-Frank Act was initially written with the intent to impose the same Fiduciary Standard on anyone who gives investment advice, regardless of their compensation scheme, and to make the Suitability Standard obsolete. Broker-dealers realized immediately that trying to adhere to a Fiduciary Standard would literally destroy their business model and ultimately put them out of business altogether! So it is no surprise that they have fought tooth-and-nail against the application of a universal Fiduciary Standard to all investment advisors.



At first the broker-dealers wanted to have the provision entirely removed from Dodd-Frank. That didn't work! Then they wanted the definition of what constitutes a Fiduciary Standard to be watered-down to the point where it would resemble little more than their own current Suitability Standard. That lobbying effort has worked to a very limited extent; but, so far, only as it is applied to investment advice given to ERISA-qualified retirement plans.

Unfortunately, the intended application of the Fiduciary Standard to anyone who provides investment advice to individuals is still waiting in the wings. The responsibility to define and apply the rule has been handed-off to the SEC at the same time that politicians (funded by sizeable broker-dealer campaign contributions) drastically cut the SEC's operating budget. The SEC is now hard-pressed to perform the basic regulatory duties with which they had originally been entrusted by the Investment Advisors Act of 1940. The SEC does not have the additional resources that would be necessary to define and apply the Fiduciary Standard. The result is that we are still waiting after five long years for the SEC to define and implement this important provision. With the amount of money from broker-dealers that is being poured into defeating it, don't hold your breath for its implementation anytime soon!

Meanwhile, in a veiled attempt to circumvent the inevitable application of the Fiduciary Standard, broker-dealers are beginning to change subtle things about how they refer to their registered representatives without actually changing anything about the way they do business. Now we rarely see registered representatives referred to as "investment advisors." Broker-dealers prefer to call them "financial advisors," or "investment counselors," or "wealth advisors," or some variation thereof. This is probably so that they can claim an exemption when a Fiduciary Standard is finally applied to all "investment advisors." Further, some broker-dealers have required that their registered representatives relinquish their CFP® (Certified Financial Planner®) designation. This is because the CFP® Board of Standards has clearly defined the Fiduciary Standard and requires anyone holding themselves out as a CFP® to fully adhere to this strict standard. Some broker-dealers have structured their compensation schemes so that registered representatives can charge fees as a CFP® for doing financial planning only to turn around and earn commissions on products they sell when implementing their "financial plan." (This is commonly referred to as "double-dipping.") To maintain the appearance of competence in the eyes of the investing public, one broker-dealer has gone so far as to refer to each of their registered representatives as a "vice president." That broker-dealer has approximately 17,000 registered representatives who are now all referred to as "vice presidents!" I doubt if vice presidents will be required to adhere to the Fiduciary Standard!

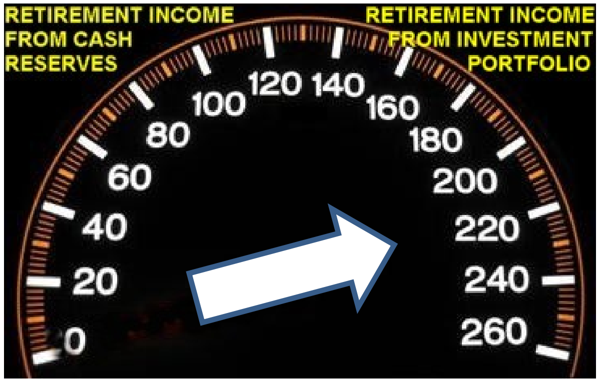
The bottom line is that, if you seek investment advice, you should require your investment advisor to provide you with a written, full disclosure of all of their sources and amounts of compensation as well as an understandable explanation of their potential conflicts of interest (like being limited only to their broker-dealer's approved product list). If you are satisfied with your investment advisor's disclosures, keep them. But if they balk when asked for that disclosure, fire them! If enough clients fire their commission-based advisors, those advisors will jump-ship from their broker-dealer affiliations to become fee-only Registered Investment Advisors. (Many are already doing just that!) Problem solved!

Retirement Funding Sources

Theory: By utilizing non-correlated retirement income funding sources from which withdrawals are taken relative to the strength of their mutual divergence, it may be possible to extend the duration of the income stream being provided by a portfolio of securities so managed.

English Version: It is our recommendation that you accumulate between one- and three years-worth of basic living expenses and hold them in cash reserves. *(Even cash reserve accounts should be properly structured. We'll help!)* During periods of stock market weakness, you should avoid liquidating investments at a loss. Use cash instead. *(You must stay invested if you are to have any chance for recovery.)* During periods of relative stock market strength you should fund your retirement income needs by taking withdrawals from your investment portfolio while replenishing your cash reserves for the next time when *(not if)* the stock market suffers another significant correction. *(Of course, it is essential to skillfully structure and effectively manage your investment portfolio. We'll do that!)*

CURRENT RECOMMENDED SOURCES FOR WITHDRAWALS TO FUND RETIREMENT INCOME



LEGEND
0 - 87: Stop all withdrawals from investment portfolio. Use cash reserves.
88 - 173: Blend withdrawals from investment portfolio and cash reserves.
174 - 260: Take withdrawals from investment portfolio. Replenish cash.

If you like the concept of maximizing the lifespan of your retirement withdrawals but you do not wish to take on the responsibility yourself, please consider enrolling in our Strategic Withdrawal Management[sm] (SWM[sm]) service. We will deal with the management logistics while you deal with your golf swing.

Current Mortgage Rates

HOME MORTGAGE: The following are the national averages of mortgage rates (source: Bloomberg Business). Because mortgage interest rates change throughout each business day, these recent examples will not necessarily be applicable when you apply for your next mortgage. They are provided for illustrative purposes, only.

RECENT CONVENTIONAL CONFORMING FIXED MORTGAGE INTEREST RATES

30 Year Fixed Rate Conventional/Conforming, 30-Day Lock	
Current 3.90%	Previous Month 3.77%

15 Year Fixed Rate Conventional/Conforming, 30-Day Lock	
Current 3.06%	Previous Month 2.95%

- There are several other factors that affect the rate of your loan. Such factors include the state in which the mortgaged property is located, loan-to-value, FICO credit scores, cash-out refinance, high-balance loans, variable-rate loans, government programs (such as FHA or VA loans), non-owner occupied, self-escrow of property taxes and homeowner's insurance, etc.

You will need to provide your independent mortgage broker with the following documents when applying for a loan:

- Signed and dated loan application and mortgage documents.
- Most recent 2 month's pay stubs.
- Most recent 2 years W2's and tax returns).
- Most recent 2 months statements on all financial accounts such as checking, savings, retirement, stocks, etc.
- Property/casualty/liability insurance carrier.
- Official military, divorce, separation, child support documentation (if applicable).

Web Links

Full disclosure of all the services we provide and all the fees we charge can be viewed at the following link to our *SEC Form ADV Part 2A*:
http://www.colsonfinancial.com/sites/default/files/users/colsonfinancial/pdf/ADVnew.pdf

You may view our privacy policy at the following link:
http://www.colsonfinancial.com/sites/default/files/users/colsonfinancial/pdf/BBB_PrivacyPolicy.pdf

You may review our fee schedule at the following link:
http://www.colsonfinancial.com/sites/default/files/users/colsonfinancial/pdf/FeeSchedule.pdf

You may log in to view your account(s) at the following link:
https://www.trustamerica.com/liberty/desktop/cfi

Please contact our office if you prefer to receive these documents via snail-mail.

PLANNING AND INVESTMENT ADVISORY SERVICES

When we work with individual clients, we focus on two areas:

- **"Fee-Only" Financial Planning:** Together we calculate what you earn and what you spend (cash flow), what you own and what you owe (net worth), and we structure a course of action for the successful achievement of your financial goals. We have no broker-dealer affiliation. We do not sell any products. We earn zero commissions and we receive zero 12b1 fees.
- **"Fee-Based" Investment Management:** We provide affordable professional investment management with honesty, integrity and exceptional fiduciary care. Our portfolios are designed to be 99%$^+$ fossil fuel-free. Our compensation amounts to a small fraction of a percent of the total of all of your family's accounts. We strive to earn investment returns at a risk level that you can accept while keeping the total of all expenses at a minimum.

A) We avoid all financial products that pay commissions. Product sponsors charge higher expenses in products that pay commissions. Higher expenses result in poorer investment performance.
B) The cost for our investment advice is fully disclosed, in actual dollars, not buried somewhere in a prospectus as "basis points."
C) We dispel the myths and misconceptions of any anecdotal advice that may be dispensed by your well-intentioned friends or relatives.

We believe that your financial success will be better achieved with ongoing professional investment management driven by an unwavering discipline to remain focused on your goals. If you have neither the time nor the desire to be a "do-it-yourselfer," please allow us to be your fiduciary. We will always place your best interests ahead of our own.