The Ethical Treatment of Somebody Else's Money

Straight From The Horses' Mouth

May 12, 2017

In This Issue

Coming Attractions

IT'S TIME TO KILL THE 3 ETF PORTFOLIO

First off, it is NOT a managed account.
Second, Advisors selling it as a managed portfolio are ripping their client off on fees.
Third, there is little art in picking 3 ETFs
Fourth: Advisors add no value in handing clients 3 ETF model portfolios.
Fifth: If an investor is [paying an asset-based fee for a ETF product, they are paying too much.

A few months ago I said "It's time to abandon the asset based fee. Let's classify the 3 ETF (or 5, or whatever; it really doesn't matter) portfolio for what it is—a product. So, we should charge for it like you charge for products: A Flat Fee. I recommend $59. Oh, if you want rebalancing for that, then it's like buying product replacement insurance: 1 year $49, 2 years $74.95 and 3 years $128.50.

That's about what it's worth.

The separately managed account for individuals was created by John Ellis and Jim Lockwood in 1973. It was modeled on the institutional consulting model of : "I'll find you a money manager and you can have your portfolio managed just like the IBMs of the world. Investment consulting was born. It started to die in 1995 and is virtually buried now.

Money managers picked stocks and bonds according to a methodology like buy and hold, active trader, asset allocator, and so on. Where are they now? The big guys like Invesco went to funds, lots of funds. Other active investors like Louie Navallier and Bob Olstein actively manage portfolios for individuals and institutions as well as putting out funds for smaller investors. Ken Fisher has a novel idea, he customizes portfolios for the individual. And he admits the dreaded "I might be wrong". (Continued on page 2)

IT'S TIME TO KILL THE 3 ETF PORTFOLIO CONT.

Then, there's the other side of the investment management business. And, I use the term "management" very loosely. Advisors work for firms who provide model portfolios along a few asset allocation strategies. Or, maybe they buy an asset allocation modeling service from another firm. Either results in the same thing. Granted, some modeling is good, maybe very good, but, seriously, models to put clients in mostly passive investment funds, the worst of those being a couple ETFs (*SEE: "ETFs: The Next Bubble", next week.}*, with no active management; just maybe an annual rebalancing are not separately managed accounts. They should not be treated as such. Even monthly, rebalancing is NOT event-driven; it's schedule driven. Like I said , a product. Products are not necessarily bad. What I object to is the situation when an Advisor represents to an investor that their portfolio is being managed. They are not.
If you want to get into the active-passive argument, both sides are represented. Just last week the State of Pennsylvania said they were phasing out their actively managed portions of their investment portfolio and moving to passive low cost funds. It will save the fund $5 Million a year in fees, and that's very good for beneficiaries. But, then the PA representative said that the active managers hardly ever outperformed the market. The studies he cited talked about funds, actively managed funds. I wonder what ever happened to separately managed accounts?

At least PA now is assured that the individual passive funds will not outperform their benchmarks net of fees. Ever.

So these product Advisors charge a bundled fee (the next thing to kill) which included the Firm that builds or provides models, the cost of purchasing or selling the ETFs in the models, and the Advisor. Guess which party gets the biggest part of the fee? The Advisor. For what? Some of Advisors will say, they get paid to prevent the client from blowing themselves up; you know, hand holding and the like. No they don't. Not unless they actually WORK for the client's best interest.

But back in the day, there used to be a handful of Advisors who did just that. Before there were ETFs some few Advisors believed that their job was to work for their client. They researched individual stocks and bonds, and did not just take the firm's in house pandering. . So these few stock jockeys did their own thing and actually managed client's portfolios in the best interest of the client.

In house products, you ask? Hah!. 95% to 98% of the revenues at big investment firms like the M&Ms (but not exclusive to Mars) comes from in house products or payments from vendors who pay to have their products on the Big Firm's shelf. Investors should, for the most part avoid these products like the plague, unless there is a very specific need for one—like long term care insurance, for instance.

I hear the cynics—advisors and investors—out there saying nobody beats the market net of fees. Active managers never neat indexes. But, you know what? They're wrong! I can, and will give you a few active separate account managers who regularly beat "the market" (Your definition here), without taking inordinate risk. They are masters of the lost art of picking stocks.

Here are two real examples, but no real names.
1. Let's call him Joe. He has personally managed my money for 30 years. He has outperformed the S&P 500 for 29 of them. He has never been more that 65% invested in equities. What about risk, you ask? Who cares? If you're old school enough to regard risk as standard deviation, try 30 years under 2.0. He stays small intentionally—under $1 Billion. He loves and lives what he does because he believes he has to WORK for his clients. He manages my kids IRAs, so you know he doesn't just take the wealthy Long Island elite.

2. Let's call him Freddie. He was a momentum analyst. He doesn't manage anybody's money, other than his and his family's. He is the BEST predictor of what will happen in the market I have ever met in 44 years in this business. He has an 80% hit rate. He knows stocks by what they do today compared to last week, month, year. He knows the stocks he picks—maybe 20 or fewer—better that any Street market maker, and he has no axe to grind. Only himself. I asked him a million times if he wanted to manage somebody else's money. He said "Nah; there's no fun in that." He doesn't need to. So what if you can't hire him? Fredide's an example of this dying art. There are other Freddies out there. (Continued on page 3)

IT'S TIME TO KILL THE 3 ETF PORTFOLIO CONT.

But, somewhere along the way, the "I got to work" spirit of taking care of somebody else's money devolved into "provide the lowest cost product with the least care and the least amount of work."   Providing value to clients? Digest this: I had an Advisor tell me a few months ago that he spent a lot of time to acquire the _______(fill in the blank with any letters you choose) designation and they deserved the be paid for that when they threw clients into some asset allocated ETF model. NO THEY DO NOT DESERVE TO BE PAID ANYTHING. Whatever happened to EARN IT?

A lot of time is spent here on *Seeking Alpha* about the value of Advisors to investors. 75% of the investors on this site will say, "Not much").   There's a reason for that, and the investors are right.

There are probably about 111 stock jockeys left out there who really work for their clients, and I know 56 of them personally. In my SEARCH FOR THE ETHICAL ADVISOR, I want to meet the other 55 and promote the hell out of them.

But, I digress….

A BITCOIN ETF? SERIOUSLY?

Last month, the SEC trashed an application to listA Bitcoin ETF. Under corporate pressure (from the financial firms, now,
The SEC said they will review that decision.

An ETF that tracks a mythical digital currency bitcoin that has no financial fundamentals, no earnings except for the collectors, and a handful of peculiar markets.
A more-than-three-year effort by investors Cameron and Tyler Winklevoss to convince the SEC to allow it to bring the Bitcoin ETF to market stalled when the agency's staff ruled against them in March.

Based on what I read from the proponents, "Bitcoin is a virtual currency that can be used to move money around the world quickly and with relative anonymity, without the need for a central authority, such as a bank or government. A fund holding the currency could bring more professional investors to the asset and push its price higher."
All in the name of profits, right. Do you think the description is self-serving?

What about risk? At least with Kruegerrands, there was a country involved; and, they're GOLD! I could not find Bitcoinstan on any global map.
It is virtual.

There's nothing behind it.

What about cyberscamming or cyberstealing? Governments have not rushed to endorse it., although some merchants have. China is going to endorse it as a currency. Does that give you comfort?

The Chicago Board of Exchange applied to list it on their BATS exchange (Whatever the hell that is)
It apparently sells for something like $1250 or so.
Jamie B. Campany owned two Florida-based companies he used to run a precious metals Ponzi scheme. They were touted as "precious metals investment firms. He was caught, jailed (12 year sentence) and ordered to pay $17.2 million back to investors.

It WILL happen to Bitcoins.

Still, some people will buy it as an "investment". Monopoly money is safer.

WHO IS WINNING THE CLASS ACTION GAME?

We do a lot with fraud on somebodyelsesmoney.com, mostly in recounting war stories in the hope that investors will not let history repeat itself. So in 2016 there were more class actions on fraud allegations than any other year. Who made out? The top 50 Plaintiffs' law firms representing institutional investors and individual shareholders in raking in a combined $7.23 billion in class action settlements over the course of the year, according to a new report released Thursday.

The report, published by ISS Securities Class Action Services, ranks plaintiffs' firms based on the total cash amount made available to investors in settlements finalized in 2016. Robbins Geller Rudman & Dowd LLP tops the list, having negotiated more than $2.7 billion.

As a side note, I have done pro bono read: "free") work representing some investors in the Madoff case (still not done yet), and for more than 5 years law firms were paid hundreds of millions of dollars before investors got a dime. The initial distribution for most investors was last year. The lawyers got big bucks since 2008, though.

DANTE'S CORNER

Here we examine the frauds and scams of the week, as announced by the Regulators. We identify the perpetrators. We assign them a Dante's Heat Index © depending how bad we think the perpetrators were. We also list all the crooks announced, and archive them for your reference. Don't do business with these guys.

Be sure to check our website out for more great articles and educational materials.