THE PAPYRUS

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The Good News

The problem with writing a financial newsletter is that so often the topics seem to be downers – avoiding fraud, estate planning, market risk, etc. In this article, we promise nothing but good news.

1. **You can become rich. Maybe not billionaire rich, but definitely among the high net worth.**

   Becoming rich is very doable even at lower income levels. There are janitors and waitresses who died leaving million dollar legacies. The rules are relatively simple: Live below your means, save money and invest it wisely in assets or business ventures with a good potential for success. Diversify, don't put your eggs all in one basket. Know what you are invested in and why, and make time to follow your investments' performance. The more time you have until you need to reach your goal, the better.

2. **You can live a happier life.**

   Take the time to figure out what you enjoy that makes you a better person and then do it. Don't hang around with downers or people who don't make you a better person. While money may help, you don't need money to be happy. You need activities you enjoy and are willing to work at.

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The Common Yardstick of Investment Success Has Its Flaws

There's a one-size-fits-all mentality to much of the news coverage of investing, which typically defines successful investment strategies and successful investment managers as those that "beat the market." Active management fails, maintains the media, because the majority of active managers have not outperformed their benchmarks over the last 10 years (although there is a significant number who have done so).

In reality, the success of an investment strategy is determined how well it meets the investor's goals.

While most investors would prefer higher versus lower returns over a

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The $5 Trillion Pension Problem

One of the big unknowns bearing down on the U.S. will be the impact of underfunded state and local government pension plans. On a national basis, public pensions are short an estimated **$5 trillion** of the funds they need to meet future obligations according to the Actuarial Standards Board's Pension Task Force. Under current practices, the public pensions industry maintains the deficit is merely a $1-3 trillion number. Based on current standards, the states with the worst underfunding as of 2015 data are:

- New Jersey – 37% funded
- Kentucky – 40% funded
- Illinois – 40% funded
- Connecticut – 49% funded
- Pennsylvania – 56% funded
- South Carolina – 58% funded

The states actually look relatively healthy compared to the worst of the cities based on unfunded liabilities:

- Chicago, IL – 28% funded
- Springfield, MA – 29.5% funded
- Portland, OR – 35% funded
- Newark, NJ – 35% funded
- Charleston, WV - 38% funded
- Billings, MT – 41% funded

A bear market could put them even further underwater. With only three sources for funding liabilities – employee contributions, government/employer contributions and investment gains – underfunded public pensions could indicate (1) dramatic tax increases on the horizon, (2) reduced benefits and/or increased employee contribution requirements or (3) bankrupt public entities.

Source: Center for State and Local Government Excellence – Public Plans Database

Combatting Financial Exploitation of Seniors

Willie Sutton was once asked why he robbed banks. "Because that's where the money is," he reportedly replied. When it comes to financial fraud, all too often the elderly are victims because they have accumulated assets over their lifetime. But there's another factor that contributes to elder fraud. Research indicates that age-related changes in the brain make it harder to detect suspicious body language and other warning signs that people may be untrustworthy. Regardless of the cause, financial exploitation of the elderly is on the increase and costs billions each year.

To combat financial exploitation of investment accounts of the elderly, the SEC has approved (1) the adoption of new FINRA Rule 2165 – Financial Exploitation of Specified Adults – to permit brokerage firm representatives/members to place temporary holds on disbursements of funds or securities from the accounts of specified customers where there is a reasonable belief of financial exploitation of these customers; and (2) amendments to FINRA Rule 4512 (Customer Account Information) to require members to make reasonable efforts to obtain the name of and contact information for a trusted contact person for a customer's account. Both become effective February 5, 2018.

The definition of "specified adult" in Rule 2165 covers those investors who are particularly susceptible to financial exploitation. A "specified adult" is (A) a natural person age 65 and older or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.

The rules "permit" but to not require the securities representative's action. They do provide financial professionals with a safe harbor from other requirements that would penalize them for failing to follow client instructions on a timely basis.

The National Adult Protective Services Association has published the following list of common scams:

Common Scams by Strangers

- Lottery & sweepstakes scams "You've already won! Just send $2,500 to cover your taxes"
- Home repair/traveling con men "We're in your area and can coat your driveway / roof really cheaply"
- Grandparent scam: You're called and told your grandson is in jail and needs you to send money immediately
- Charity scams: falsely soliciting funds for good causes; very common after disasters
- Roof repair, yard work, home repair scams
- Telemarketing scams and accompanying threats

Common Scams by "Professionals"

- Predatory Lending – seniors pressured into taking out inappropriate reverse mortgages or other loans
- Annuity sales – the senior may be pressured into using the equity realized from a reverse mortgage (or other liquid assets) to buy an expensive annuity which may not mature until the person is well into their 90's or over 100
- Investment/securities schemes – pyramid schemes; unrealistic returns promised; dealer is not licensed
- Internet phishing – false emails about bank accounts
- Identity theft – credit cards opened fraudulently, etc.
- Medicare scams – these are the costliest in terms of the dollar amounts

Common Scams by Family Members and Trusted Others

- Using a Power of Attorney, given by the victim to allow another person to handle his/her finances, as a license to steal the victim's monies for the perpetrator's own use
- Taking advantage of joint bank accounts in the same way
- Using ATM cards and stealing checks to withdraw monies from the victim's accounts
- In-home care providers charging for services; keeping change from errands, paying bills which don't belong to the vulnerable adult, asking the vulnerable adult to sign falsified time sheets

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3. There is a wealth of information to help you.

We have never had as much free information at our fingertips in all of history. YouTube alone offers more how-to videos, entertainment and education than you can absorb in a lifetime. Computing power is cheaper than ever, free wi-fi abounds and if you lack a computer or wi-fi just visit your local library.

4. You don't have to go it alone.

Peer groups, social support groups, internet exchanges, and even just posting comments to articles can help build lots of connectedness to a larger world. Volunteering is a great way to get into events and activities that you might not otherwise. Here again, the internet is a big resource. Search for groups that like what you do, Facebook pages, and so much more, including just sites where you can post your thoughts.

5. Take chances.

Sometimes it seems like the media functions purely as a device to scare us out of leaving our homes and ruts. The world is a surprisingly welcoming place given a little common sense. If you really look at the statistics, the odds of something bad happening to you are pretty small. Combine that with a little caution and being aware of your surroundings and where you should not be, and step out into life.

The Fiduciary Standard and Its Impact on Investors

Effective June 9th, the U.S. Department of Labor imposed a fiduciary standard that requires stewards of retirement savings accounts to act in their clients' best interest. Many elements of the 1000+ pages of regulation are currently in force; other provisions will become active in January 2018. There is a chance, however, the rule will be substantially revised or even eliminated by then.

Until then, the rule impacts all financial advisors who provide financial management, advice, investment and oversight of retirement accounts - *defined-contribution plans: four types of 401(k) plans, 403(b) plans, employee stock ownership plans, Simplified Employee Pension (SEP) plans and savings incentive match plans (simple IRA); defined-benefit plans: pension plans or those that promises a certain payment to the participant as defined by the plan document, and Individual Retirement Accounts (IRAs)*. It only applies to retirement accounts because this is the extent of the DOL's authority under the Employee Retirement Income Security Act of 1974 (ERISA).

ERISA is a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for individuals in these plans. There is an effort underway to have the SEC establish a universal fiduciary standard to cover all investment accounts – but that is still in the future.

Registered Investment Advisors have always been fiduciaries to their clients under the Investment Advisers Act of 1940. While the 1940 law did not define the duties of a fiduciary, over time and legal rulings, the standard evolved to require that an adviser:

- Exercise due care (prudence and reasonableness) when acting on behalf of clients.
- Employ reasonable care to avoid misleading clients.
- Have a reasonable basis for investment advice.
- Seek best execution of clients' trades.
- Act in the best interest of clients.
- Place the interest of clients above its own.

This standard was significantly broader than that which applied to insurance agents and securities representatives and broker/dealers, who were expected to:

- Treat customers in a fair manner characterized by high standards of honesty and integrity.
- Place the interests of the customer first.
- Disclose all material information in connection with an investment recommendation
- Not execute trades in a customer's account unless the customer approved and authorized the trade in advance, or had given the broker discretionary trading authority
- Make investment recommendations consistent with the customer's financial status, investment objectives, level of understanding and risk tolerance.

Unfortunately, in developing its fiduciary standards for retirement accounts, the DOL moved beyond broad-based concepts to minutia. The regulations that begin to take effect on June 9th are 1,023 pages in length. The new rule automatically elevates all financial professionals who work with retirement plans or provide retirement planning advice to the level of a fiduciary, bound legally and ethically to meet the standards of that status. While this will have the most effect on securities brokers and insurance agents, who are paid on a commission basis, registered investment advisors will be affected as well by the regulators' attempt to detail the responsibilities of the fiduciary and disclosure requirements.

The new DOL rules are expected to increase compliance costs, particularly for smaller, independent broker dealers and RIA firms without the financial resources to invest in the technology and the compliance expertise to meet all the requirements. Rollovers from 401(k) plans to IRAs are expected to come under increased scrutiny, as will fee arrangements. Many analysts expect the new regulations to drive the growth of robo-investing with less risk of human interaction or conflict in investment decisions. There is also considerable concern that servicing small accounts will become un-economical, resulting in fewer options for smaller accounts.

Retirement investors can expect increased disclosure documents on the RIA's fiduciary duties, impartial conduct standards, fees – including the "Level Fee exemption" and a host of other issues.

While the intent of the DOL fiduciary rule is admirable, investors always need to be aware that those willing to exploit and defraud others are rarely stopped by laws, regulations or disclosure requirements. The investor must always be alert to promises that are too good to be true, the lack of independent third party statements, improper payment arrangements and many other fraudulent actions. Crimes can be detected only after they have taken place and that is typically too late to recover the investor's funds.

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given period, they also have a wide range of objectives that don't necessarily include beating the market, particularly when it comes with the risk of market downturns.

Capital Preservation

For those individuals who have reached the status of high-net-worth investors, keeping what you have achieved and avoiding major market downturns becomes more important than maximizing return. Their performance goal may be to offset the impact of inflation and taxes, but manage the risk of losing money. Retirees also tend to focus on capital preservation versus return, particularly when chasing higher returns comes with the risk of a 20-50% bear market loss at a time when they have limited options to rebuild their portfolio.

Growth

Most investors don't have the luxury of knowing they are adequately funded to make it through retirement and need their invested capital to grow in value. But these investors often find it hard to buy and hold through market volatility and the emotional impact of bear market losses or ongoing negative media coverage. A low-cost index fund with its market volatility may not be an appropriate investment. Adding a layer of financial management can mean the difference between growing assets and failing.

Income

Many individuals invest with the objective of generating income. Appreciation or losses in the current value of the underlying investment are not as important as the income stream it provides.

Tax exemption

There are investments that offer the ability to reduce current tax liability through depreciation or expenses that can be recovered later, typically through a sale of the asset. Other investments may offer the potential to convert short-term gains to long-term capital gains, resulting in more favorable tax treatment.

Liquidity

When an investor anticipates a near-term need for cash, liquidity may dominate his or her investment objective. A successful investment becomes one that provides a modest return, but is available when needed and less vulnerable to declines in value.

In each of these objectives, it is unlikely the investor will equal or outperform the S&P 500 index. But that doesn't make the investment unsuccessful. Passive one-size-fits-all investment approaches may well be one of the most dangerous bandwagons the financial media has ever jumped on. There is very much a place for investment advice shaped to the needs of the investor. We would argue good investment advice is well worth the fee it costs when it allows investors to meet their objectives. Risk must always be a consideration in the investment decision.

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