LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

This issue of Outlook and Trends discusses the different kinds of financial advisors and the concept of a financial fiduciary, in addition to reviewing the current condition of the economy and markets as we always do. The fiduciary issue is important to consider as you retain and work with a financial advisor to build and execute your financial plans. You want to make sure your advisor's allegiance is 100% to you. Also, you will find our business card included. I hope you will tuck it away in safe place for when you need it, or give it to a friend who might need financial planning or management assistance today.

Economy

The Federal Reserve has seamlessly changed from a policy of raising rates to remove monetary accommodation to raising rates to ward off potential inflation. Every month or so the pundits attempt to psychoanalyze the Fed's Open Market Committee and wind up predicting a stopping point that is ¼ percent higher than the prior month's forecast. Rather than try to predict the end of the rising rates, it makes more sense to take the Fed at its word. They will stop the rate increases when economic data show that inflation is under control.

The level of rates is, of course, of great importance. The higher the rates become, the greater the chance of a more significant slowdown. Bond values and the real estate market are already directly experiencing the effect of rate increases. Other businesses and stocks will be affected eventually if rates continue to rise. For now, however, economic conditions are very good. The economy grew fairly fast at a real annual rate of 5.6% in the first quarter, up from 1.7% during the last quarter of 2005. Employment is high. Corporate profits have grown rapidly (28.5% over the last 12 months), but salaries have not kept up, rising at about a 3.5% rate. Consumers are a bit more pessimistic than normal.

Financial Markets

The stock market hit its post-bear-market peak in May, and prices have been falling fairly continuously ever since, led by the smaller stocks and commodity sectors that had been posting the big gains before. Likewise, bond prices have been falling as yields have risen as a result of the Federal Reserve's interest policy. We have mentioned more than several times since the market bottom in 2003 that stocks have been undervalued in relation to bonds. This is still true, although not as much as before. The implication remains that in order to restore parity, stocks must rise or bonds must fall, or both. This adjustment process has been occurring slowly since we first mentioned it, and as yet there is no distinct sign of it ending, although the rate of gain in stock prices may be slowing down.

There is no law that says that markets must follow historical averages, but they often do. Unfortunately the third quarter of the year tends to be the weakest. Not only that, but the second year of the four-year presidential term tends to be the weakest year. So here we are, in the third quarter of the second year. This is not a prediction by any means, but we thought you might like to know.

The Advisor and the Fiduciary

Before 1999, roles within the financial industry were clear. That changed when the Financial Services Modernization Act was passed and insurance companies started selling mutual funds, stockbrokers started selling insurance, and banks began selling both. After these changes, insurance agents, stockbrokers and bankers all began to call themselves "financial advisors". Identifying their real role has been more difficult ever since.

One of the important distinctions to make is whether or not your advisor has a “fiduciary” relationship with you, meaning that your advisor must place your interests *before* their own self-interest. Doctors, lawyers and trustees are all fiduciaries. This distinction is basic and obviously important. If your advisor’s relationship is not clear to you, you are not alone. A study* by TD Ameritrade found that only 26% of investors knew that Registered Investment Advisors (RIA) must be fiduciaries, while stockbrokers are not. Insurance agents, real estate agents, and mortgage brokers also are not required to be fiduciaries. In fact, it is difficult to see how any commissioned sales relationship could be a fiduciary relationship, because of the inherent potential for monetary conflict of interest.

The US Securities and Exchange Commission recently issued Rule 202 that exempts stockbrokers from the Investment Advisors Act of 1940, which requires investment advisors to act as a fiduciary. In an attempt to clarify the difference between the brokerage function (including fee-based accounts) and that of a Registered Investment Advisor, the rule requires brokers to disclose, “*Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours...”* Furthermore, the rule says that stockbrokers may only provide investment advice that is “*solely incident to the brokerage services provided*”, i.e. brokers may only advise you about the products they are selling to you. They may not say they are a financial planner, deliver a financial plan to you, or say that the advice provided is part of a financial plan.

Making it even harder for you to distinguish, a company that provides brokerage services might also have set up an advisory subsidiary to provide you with planning advice under a separate agreement for an additional fee. They are then permitted to “wear two hats”, but the planning services must be provided as a Registered Investment Advisor. This means that the advisor must accept the additional responsibility of being a fiduciary to you. Since it may not be clear which type of relationship you have, you may want to ask your representative whether they are a fiduciary.

How can you tell if your financial advisor is a fiduciary or a sales agent?

- If commissions or mutual fund loads are involved, it is most likely a sales, not a fiduciary relationship.

- In determining whether an advisor is a fiduciary or not, generally ignore designations like CLU, ChFC, CFP®, Series 7 etc., which are certifications or licenses that are earned through education and experience. Fiduciary status is related to function or position, such as Registered Investment Advisor, Trustee, or Qualified Retirement Plan Officer. Other fiduciaries, such as NAPFA-Registered Advisors, agree to act as a fiduciary as a condition of membership in an organization.

- Ask who licenses the advisor or regulates your business with them.
  - If it is the National Association of Securities Dealers (NASD), Real Estate Board, or State Division of Insurance, your representative is not a fiduciary.
  - If the regulator is your state’s Securities Division or the US Securities and Exchange Commission, your advisor is an RIA and a fiduciary.

To learn more about *LFM&P* financial planning and investment management services, our client goal-centered financial philosophy, and to better understand the value we can bring to your financial life, we encourage you to contact us or look at our website, www.linnardfinancial.com.

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*www.amtd.com/governance/advocacy.cfm , “TD Ameritrade Investor Perception Study”

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