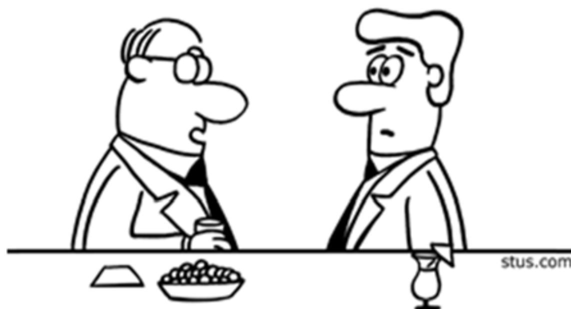
Our Proverbial Soapbox

While we don't often climb onto our proverbial soapbox, a recent television ad from a well-known Wall Street brokerage company has us looking around for it. It is completely farcical when a television commercial for a brokerage company has an actor portraying an experienced-looking broker giving advice to a seemingly appreciative older couple. Soothing music emanates while words like "trust" and "partnership" appear in esoteric font, scrolling across the screen. Oh, the agony!

If a person were to reach out to that firm, here is the disclosure buried somewhere in microscopic font on the account application: *"Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our salespersons' compensation, may vary by product and over time."* Wait, what?!? What happened to the knowing silver-haired gentleman on the screen who looked so trustworthy?



This "fiduciary" thingy really complicates pillaging a corporation.

The material difference between brokers and fiduciaries revolves around ethics. The ethical criteria of fiduciary duties are the essence of what we at Rockwood think of as character. They provide the foundation for best practices regarding conflicts, fee/expense transparency, elimination of intentional opacity, and clarity of communications. These principles represent established fiduciary doctrine, embedded in centuries of law. They are noteworthy for their uncomplicatedness—for their retention of fundamental truths. At their core, these principles reflect how we think about and seek to render objective advice—how we view our professional duty and serve our clients' best interests.

> ***…which will remain nameless since it employs more attorneys than Rockwood Wealth Management has paper clips.***

Applying the rule of straightforward communication may best distinguish fiduciaries from others. We strive to make sure clients know the risks they take, the services we deliver, and the fees they pay. It's what fiduciary advisors do and what so emphatically distinguishes "advice" from "sales." These principles contrast starkly with many underlying principles upholding brokerage sales practices that either are, unfortunately, legally permissible or have become de facto permissible.

Explicitly, all brokers say they do right by their customers—and some brokers do so and operate as near to the fiduciary standard as investors expect. Implicitly, however, a very different picture emerges when one is exposed to the underworld of brokerage industry lobbyists who vigorously defend and protect

conflicted advice; opaque fees and expenses; and misleading, incomplete, or incomprehensible communications. These brazen proclamations echo clearly and unmistakably from the very highest perches of leadership in most popular brokerage companies.

Examples are ubiquitous, so much so that they often go unnoted. Rarely, if ever, do brokerage lobbyists criticize or discourage conflicted advice; one lobbyist has actually suggested that conflicted advice is good for investors. To mention one of our recent favorites:

A New York district judge scolded a very large global brokerage firm (which will remain nameless since it employs more attorneys than Rockwood Wealth Management has paper clips) for actually arguing in a legal proceeding against it that its own statement of putting investors' interests first was mere "puffery," and so its trading practices to its own advantage and to the detriment of its clients were perfectly legitimate.

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The public is screaming loudly and clearly about financial services: be more sincere, be more honest, and be more transparent. This notion is not a secret, nor has it ever been. Why, therefore, is it so hard to establish a fiduciary standard across the brokerage community? It seems obvious that's the right thing to do. Why are conflicts of interest still allowed in this modern age of information?

I know we're supposed to be totally loyal, but to whom?

In fact, conflicts of interest have long been acknowledged by regulators as undermining independent and objective financial advice for the better part of 80 years. The Investment Advisers Act of 1940 was literally conceived from the concerns that investors would confuse advisors with product salespeople, or "tipster" organizations that disguised themselves as legitimate advisory organizations. Conflicts are deemed to be incentives, favors, benefits, or compensation that can reasonably be expected to impair objective advice. Compensation arrangements that directly alter payment levels to advisors or brokers depending on the investment strategy or product recommendations are well-known conflicts. But many conflicts are less obvious—revenue sharing, solicitor agreements, soft dollars, and sub-account agency transfer fees, to name just a few.

While disclosure is at the heart of securities regulation, the impact of disclosure requirements is mixed at best. Disclosure is often ineffective. Yale management professor Daylian Cain notes that conflicts are corrosive and that disclosure just can't be trusted as a cure-all, saying, "Investors usually do not sufficiently heed even the briefest, bluntest, and clearest disclosure warnings of conflicts." Rutgers professor Arthur Laby argues that the strongest rationale for holding brokers to the fiduciary

standard is that brokerages have advertised "trusted advice" services in explicit language and titles for decades, and have created "reasonable expectations" that brokers are fiduciaries.

Georgetown University professors Douglas McCabe and James Angel extend this argument, noting that brokers should offer advice in the best interest of the client, because "to do otherwise is fraud because then the service delivered would not be what the customer thinks she or he is buying."
As realists, we recognize that it's likely that the enormous influence and financial potency of the brokerage industry lobby will be ultimately successful in preventing brokers from being held to a fiduciary standard. With that shameful backdrop, we as fiduciary advisors must recognize too that we alone, among all industry participants, can boldly embrace the ethical principles of fiduciary duties, and can reassert in the public arena in the clearest terms possible what it means to be a fiduciary advisor. Fiduciaries alone can rededicate ourselves to this mission, because we understand the character required to deliver true value to our clients.

Proactively Addressing Risk in the Subsections of the Bond Market

We've written previously about how we need to collectively think of bonds as a shock absorber that dampens the ups and downs your portfolio will experience along its long-term upward trajectory. Our intention is to reemphasize that the inclusion of fixed income (bonds) in your portfolio is primarily to reduce volatility and provide liquidity in down markets, not to chase higher yields at the expense of taking on undue risk.

Inflows into higher yielding bonds have been unprecedented in the past few years as low interest rates frustrate retirees and other income seekers. If and when the high yield bond asset class moves out of favor due to the perception of the arrival of credit risk, investors will find that there is less liquidity in the way of natural buyers for this type of debt during uncertain equity markets.

The result is that the volatility of the high yield bond asset class is marginally greater today than it was two years ago. That liquidity risk, coupled with tightening credit spreads between high yield bonds and investment grade corporate securities, means that a measured and prudent allocation shift is warranted within the bond portion of one's portfolio.

Part of this subtle change is the inclusion of Vanguard's Short-term Investment Grade Bond strategy. The strategy is designed to give investors ultra-low-cost exposure to more than 2,200 high- and medium-quality investment-grade bonds with short-term maturities. The strategy represents one component of our bond investment approach that will not risk stretching for yield in the current low-yield environment in an effort to boost returns. Accordingly, we will be reducing the position size of any high yield bonds funds by about 50% and allocating those proceeds to the Vanguard Short-term Investment Grade Bond Fund.

The outright abandonment of high yield bonds is unwarranted, as their inclusion allows us to take less risk and increase liquidity elsewhere in the

portfolio. However, their proportion in portfolios must be continually and dutifully measured. Prudently reducing their allocation will result in a portfolio that provides more robust dampening characteristics while further strengthening the ability to resist the negative effects on bond prices when equity markets become volatile.

In the coming weeks, as we prudently blend Vanguard's Short-term Investment Grade Bond Fund into portfolios and pare back weaker credit bonds to control risk, it is important to keep in mind that this is not a change in strategy. As before, the repositioning is just a continuous implementation of our ongoing risk-based variable credit and variable maturity strategy to fixed income investing. Our evidence-based approach rejects prognostication and instead uses the current yield curve and credit spreads to determine the optimal maturities and credits to seek out in your portfolio, based on the realities of the bond market as it exists today.

National Accolades for Rockwood

While maintaining our heaping serving of humility constantly before us, Rockwood Wealth Management was pleased to be both recognized nationally as a high-performing firm and featured prominently in a book on becoming a top-tier wealth advisory firm.

Fidelity Institutional Wealth Services, a leading custodian for registered investment advisors, released *Be Greater: Why Being Good Enough Is No Longer an Option,* which recounts the inspiring stories of 20 advisors who have taken their businesses from "good enough" to "great." Of those 20 advisory firms, four were selected to speak on an expert panel before the participants at Fidelity's industry conference for advisors in New York City this winter. Not only was Rockwood fortunate to be chosen to be chronicled for the book, but John Augenblick was asked to speak to roughly 400 advisors and industry professionals about successful practice management.

For many firms, a recent shift in clientele away from Wall Street brokerage houses has brought the challenge of evolving from a small practice to a fully developed business. *Be Greater* was written in order to share wisdom from advisory leaders who have built great businesses, relative to five fundamental topics that can contribute to high performance: exploring business models, committing to a plan, harnessing technology, engaging clients, and building strong talent and teams.

We consider ourselves equally fortunate and humbled to be named alongside some of the nation's most well-respected and best-run registered investment advisory firms. We continue to serve at the pleasure of our wonderful clients, and we offer a heartfelt thank-you to all of you who have contributed to our development as an organization.

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Rockwood Wealth Management, LLC (RWM), a Pennsylvania limited liability company, is a fee-only wealth advisory firm specializing in personal financial planning and investment management. Rockwood Wealth Management, LLC, is a U.S. Securities and Exchange Commission (SEC) Registered Investment Advisor. A copy of RWM's Form ADV-Part II is provided to all clients and prospective clients and is available for review by contacting the firm.

Any performance data represents past performance. Past performance is no guarantee of future results, and current performance may be higher or lower than the performance displayed. The investment return and principal value of an investment will fluctuate such that an investor's shares may be worth more or less than their original cost.