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summaries

SIGMA INVESTMENT COUNSELORS

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"Caveat Emptor" - Buyer Beware

We recently received from our compliance counsel the text of a speech titled, "A Shared Responsibility: Preserving the Fiduciary Standard" delivered by U.S. Securities and Exchange Commissioner Luis Aguilar at the IA Compliance Best Practices Summit 2010 on March 26, 2010. Mr. Aguilar commented on the evolving federal legislation that is designed to protect the interests of investors that utilize the services of advisors. While this subject is admittedly dry, we felt the content was important enough to warrant a reproduction of the salient segments of the speech below. As many clients of Sigma Investment Counselors are aware, not all providers of investment advice are required to adhere to the same set of rules and regulations, and this is particularly poignant as it relates to "fiduciary standards." In fact, the regulation of advisors working for brokerage firms (broker-dealers) is distinctly different from the regulation that governs registered investment advisors like Sigma.

The provided internet link below will take you to the full text of the speech, or if you would like a hard copy, please contact us and we will mail it to you.

http://www.sec.gov/news/speech/2010/spch032610laa.htm

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The fiduciary standard has served advisory clients well for many years, and I believe that it should be the governing standard whenever investment advice is provided. If you are giving advice to an investor, regardless of the title on the business card, you should always be bound to do so in the best interests of the client. While the scope of service may vary between clients, the standards of loyalty and care in providing that service should not. You simply cannot be three-quarters of a fiduciary.

As you know, there has been a lot of discussion about the appropriateness of imposing a single standard on all of the various professionals that provide investment advice. Most of the discussion has involved the benefits of aligning the standard so that advisory clients of broker-dealers and investment advisers receive the same standard of care. And clearly, it makes sense for investors to expect that all securities professionals providing them with advice would be subject to the same obligations.

For the last several years, I've been listening to the ongoing debate about what standard should be applied. While many of the standards I have heard proposed are referred to as "fiduciary" standards, these standards do not offer the same robust protection as the fiduciary standard that currently applies to investment advisers. In truth, there is only one fiduciary standard, and it means an affirmative obligation to act in the best interests of the client and to put a client's interests above one's own. Accordingly, it was heartening last year to see that the Obama Administration in its White Paper on Financial Regulatory Reform explicitly stated that the standard of care for broker-dealers who provide investment advice should be raised to the fiduciary standard applied to investment advisers. This was followed by provisions in both the Wall Street Reform and Consumer Protection Act (the "House Bill") and the initial draft of the Restoring American Financial Stability Act (the "Senate Bill") that would have extended to broker-dealers the traditional fiduciary standard applicable to investment advisers.

The Senate Bill, however, has abandoned its strong position in the face of determined lobbying by the insurance and brokerage industries. The revised version that was voted out of the Senate Banking Committee on March 22nd has eliminated the provision applying the fiduciary standard to brokers who provide investment advice. It would, instead, require a one-year study by the SEC concerning the effectiveness of existing standards for "providing personalized investment advice and recommendations about securities to retail customers."

This potential retreat from requiring a fiduciary standard for all who provide investment advice concerns me for several reasons. First, I see no need to study the appropriate obligation for investment advisers. We already have a strong, workable standard that has done its job successfully for decades, and I would not support any attempt to weaken it.

Second, as with the House Bill, I question why the protection of the fiduciary standard should be limited to "retail" customers. It is readily apparent from recent Commission enforcement cases involving auction rate securities that all investors, including institutional investors, need the protection of the fiduciary standard.

Third, I question why the study, as well as the reach of the House Bill, should be limited to "personalized services." This qualification would narrow the range of clients that would be protected by the fiduciary standard, and I fear that it may become a loophole that would make it easy to avoid putting clients first.

Finally, I don't believe that we need a study to conclude that investor protection requires that broker-dealers providing investment advice be subject to fiduciary duties. I think that question has long ago been asked and answered.

As you follow this legislative development, I would ask that you listen carefully to how various proposals would seek to rationalize the standard for similar services between investment advisers and broker-dealers. There are those who believe that the calls for "harmonization" sound very much like code for imposing broker-dealer standards on advisers, not the other way around. We all need to remain vigilant to make sure that investors who receive advice do so from intermediaries that are held to the high standards of care and loyalty embodied in the existing fiduciary standard under the Investment Advisers Act of 1940.

The Economic and Market Environment

In Sum: Economic growth, in the long run, spells the direction of corporate profitability and profitability determines the path of common stock prices. If price inflation accelerates, interest rates rise and economic activity is choked off. Global stability (or a lack thereof) will also influence the direction of interest rates. If government borrowing is excessive, or central bank policy is too accommodating, interest rates could be driven higher. An assessment of the components that Sigma monitors (which are shown in bold below), taken together, suggests a relatively constructive environment for economic growth with the caveat that there is little room for error.

Geo-political: The general shape and tone of the Obama Administration foreign policy is beginning to emerge. The tenor is decidedly modest, in contrast to the much more "confrontational" approach of the Bush administration. This is not a value judgment, as the merits of either approach will take years to yield measurable outcomes. This does reflect a practical reality that the struggle between "guns and butter" is moving front and center as the US confronts significant fiscal constraints. As this newsletter was being written, President Obama was attempting to arrange a consensus on Iranian sanctions at his nuclear summit, hoping to convince Russia and China to endorse the actions aimed at curbing Iranian nuclear activities.

Economic: While it appears that economic activity is indeed improving, the progress is not necessarily uniform across the globe. A recent snapshot on real GDP growth from Bloomberg LP for 35 representative countries for the fourth quarter of 2009 indicated 16 countries experiencing expansion and 19 exhibiting contraction. The changes ranged from the 11% growth in China to the 17% drop experienced by Latvia. The US showed year over year real growth of 0.1%.

Monetary: The Federal Reserve Board (Fed) has myriad tools in its arsenal to conduct monetary policy. The administration of the discount rate and the fed funds rate are the two most widely recognized. As the economic crisis unfolded during the past two years, other measures were deployed, including having the Fed purchase mortgage backed securities to support that market. In late March, the Fed discontinued this activity as part of a measured withdrawal of supportive actions. The Fed has been reluctant to initiate increases in the discount and/or fed funds rates until further evidence emerges of a sustained economic recovery. Other central bankers have already taken action to moderate their economies (China, Australia).

Fiscal Policy: Reasonable economists differ on the role of fiscal policy in managing economic growth. Some believe that deficit financed spending during the Great Depression enabled the economy to recover (largely Keynesian trained adherents) while others believed the measures merely prolonged the economic angst (Burton Folsom and Anita Folsom). The political environment in the US is an issue of grave concern to elected officials and it appears that a growing movement for a change in approach is brewing and bears watching –

culminating with the elections that will take place in the US in the fall. This election will be closely watched by the rest of the world.

Equity Markets: Common stock prices throughout the world have continued to rebound from the lows reached in early March, 2009. The Dow Jones Industrial Average did decline by about 8% from late January 2010 to early February, but then continued its upward ascent, in concert with other major common stock barometers.

Fixed Income Markets: Earlier this month the benchmark ten year treasury yield touched 4 %. That is the highest level since October 31, 2008 according to US Treasury data. It appears that policy makers have stated clearly their pledge to keep rates low contingent on low inflation and high unemployment, among other things.

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