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INC.

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## ***DOL Fiduciary Rule – An Update***

The landscape for personal financial planning will change this year. It is highly likely we will see changes in the income tax and estate tax areas. There has grown up, to the extent it did not exist before, a cottage industry in prognostication about where things are headed. Of course, like almost all prognostications, most of these will turn out to be wrong and as always we recommend you treat prognostications with a good dose of skepticism. They are guesses. No more, no less.

One subject of interest is whether the recently promulgated DOL (fiduciary) rule, which I discussed in our 1st Quarter 2016 letter will be repealed or otherwise vacated. This rule imposes the requirement for financial advisors to operate under a best-interests of the client (fiduciary) standard when advising clients on pension accounts. The rule has been well received and widely acclaimed in the fee-only financial advisory sector of which we are a part. Less so in the world of broker-dealers and other commission-based purveyors of financial products. You'll note that in our newsletter, we supported the rule, and also noted that given our consistent and long-standing adherence to the fiduciary standard, whether the new rule is allowed to go into effect or not will not change much about how we engage our clients and deliver our services. This is still true.

It seems to us that the bell has been rung for the change to fiduciary and it will not be unrung. Several large players in the financial services industry have mobilized to not only oppose the implementation of the rule, but also to modify their business models to adopt the best interests standard. Earlier this month, we've seen congressional action designed to delay the effective date of the rule, which could lead to repeal. It seems to me unlikely that many of these organizations will, if the rule is vacated or repealed, simply turn around and go back to their prior practices. Certainly a few will, but I think and hope that most will not. The fact that the DOL rule applies only to advice given on retirement accounts, not regular after-tax accounts creates a weird disconnect. We will be interested in how they go about this adaptation. We welcome the progress.

At the core of the notion of fiduciary are two concepts: One is a solicitation of trust, or a declaration that "you may trust me", and the other is, typically, a fairly large differential in knowledge between the fiduciary and the client. So, when the "trust me" relationship is established, the fiduciary is duty bound to refrain from using the knowledge differential to lead, bend, or direct the relationship in such a way as to serve his/her own interests as opposed to the best interests of the client. Where there is a "trust me" relationship without that duty to place the client's interest above all, then bad things can, and frequently do, happen. This is where the majority of the financial services industry now lives: "Trust me, but I have no obligation to do what is in your best interest or to place your interests before my own." You can see how this is a recipe for malfeasance.

Unfortunately, many of the users/customers of the financial services industry don't really understand that their stockbroker does not act as their fiduciary. They say "trust me", but they don't have the duty to act as a fiduciary. I've seen this in action. For example, at an industry event a few years back, there was a table discussion about disclosure of commissions on financial products. The "sales" people simply did not want to disclose the commissions because they expected that disclosure would dissuade some customers from buying the product. That is, the disclosure would blow the sale and cost them the commission. I think that was a pretty clear illustration of which interests were being served in the relationship and the transaction.

Make no mistake, there is still a long way to go.

- It really does not make sense for the fiduciary standard to apply to only a portion of the client's assets.
- We would like to see the CFP Board of Standards close the "material elements" loophole and simply state that CFP Practitioners are held to the

fiduciary standard at all times. Note that the PFP section of the AICPA has promulgated standards that are pretty analogous to a general fiduciary standard without using the word "fiduciary".

- We think that the fiduciary standard ought to apply to anyone who holds out as a financial planner, financial advisor, or the like, and invites, by word or deed, the client to trust them.
- We think that the fiduciary standard ought to attach to the advisor / planner for all purposes and all circumstances. No changing of hats to change the standards and no different standards for different clients.

How will an industry adoption of the fiduciary standard affect our company?

- It is true that we will lose a differentiator that works in our favor: that we are fiduciaries and (generally) they are not. Fact is, though, that the other guys now have differentiators that work in their favor. They are able to make promises they cannot keep, and mislead folks into thinking that their products are favorable for the client, when they primarily benefit the advisor. As the rest of the industry approaches a fiduciary standard, there will be less latitude for exploiting the knowledge differential.
- Many advisors not willing to make this change will leave the business. In the UK when more stringent rules were placed on the financial services industry, there was a large attrition in advisors.

This rule, whether repealed or allowed to go into effect, validates and ratifies the posture we have maintained throughout the life of this firm. We are fiduciaries.

The table below shows the returns through December 31, 2016 for selected investment asset classes. In most cases, the results below are appropriate benchmarks for the related mutual funds in your investment portfolio.

| Asset Class | Data Series | YTD | 1 Yr. | 3 Yrs. | 5 Yrs. |
|---|---|---|---|---|---|
| Ultrashort Bonds | BofA Merrill Lynch 6-Month US Treasury Bill Index | 0.67 | 0.34 | 0.27 | 2.15 |
| Short Term Municipal Bonds | BofA Merrill Lynch 1-3 Year US Municipal Securities Index | 0.33 | 0.60 | 0.78 | 5.16 |
| Short Term Corporate Bonds | BofA Merrill Lynch 1-5 Year US Corporate and Government Index | 1.62 | 1.39 | 1.39 | 3.39 |
| Short Term Global Bonds | Citi World Government Bond Index 1-2 Years (hedged to USD) | 1.06 | 0.71 | 0.77 | 3.06 |
| Intermediate Term Municipal Bonds | Bloomberg Barclays Municipal Bond Index 7 Years | -0.50 | 2.92 | 2.38 | 4.24 |
| Intermediate Corporate Bonds | Bloomberg Barclays U.S. Credit Index | 5.63 | 4.07 | 3.85 | 2.75 |
| Intermediate Global Bonds | Citi World Government Bond Index 1-5 Years (hedged to USD) | 1.49 | 1.46 | 1.42 | 1.20 |
| US Marketwide Core 1 & 2; Vector | Russell 3000 Index | 12.74 | 8.43 | 14.67 | 5.92 |
| US Large Cap Market | S&P 500 Index | 11.96 | 8.87 | 14.66 | 7.53 |
| US Large Cap Value | Russell 1000 Value Index | 17.34 | 8.59 | 14.80 | 2.70 |
| US Small Cap Market | Russell 2000 Index | 21.31 | 6.74 | 14.46 | -0.04 |
| US Small Cap Value | Russell 2000 Value Index | 31.74 | 8.31 | 15.07 | 5.70 |
| Real Estate Investment Trusts | Dow Jones US Select REIT Index | 6.68 | 13.73 | 11.77 | 1.85 |
| International Marketwide Core & Vector | MSCI World ex USA Index (net div.) | 2.75 | -1.59 | 6.07 | 3.92 |
| International Large Cap Market | MSCI World ex USA Value Index (net div.) | 7.39 | -2.12 | 5.96 | 0.82 |
| International Large Cap Value | | | | | |
| International Small Cap Market | MSCI World ex USA Small Cap Index (net div.) | 4.32 | 1.36 | 8.96 | 2.27 |
| International Small Cap Value | MSCI Emerging Markets Index (net div.) | 11.19 | -2.55 | 1.28 | 2.63 |
| Emerging Markets | | | | | |
| Ultrashort Bonds | BofA Merrill Lynch 6-Month US Treasury Bill Index | 0.67 | 0.34 | 0.27 | 2.15 |

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