

Financial Planning

INVESTED IN ADVISERS / AUGUST 2017



\$600M

It's not how you leave ...

Ali Mandalinci
Beth Sweeney
Peter Frisch
Stephen Spector

Co-founders
Steward Partners'
newest office

...it's how you arrive



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AUGUST 2017 | VOL. 47 | NO. 8

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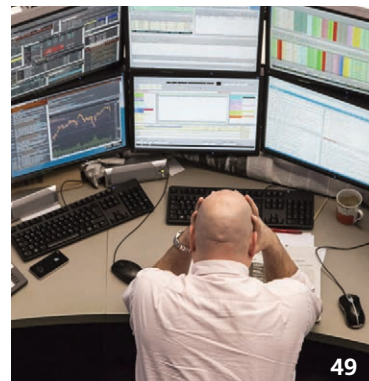
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THE SECOND HALF OF THE GAME MAKES THE DIFFERENCE

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FUNDS THAT FALL SHORT



Underperforming Their Benchmarks

Advisers could have some explaining to do if they choose investments that underperform their benchmarks, meaning clients have paid a management fee for the privilege of not keeping pace with an index. Scroll through to see the 20 mutual funds that underperformed their benchmarks the most for the past three years, on an annualized basis. Type the link into your browser to see how much these funds missed the mark: <http://bit.ly/2sNTKOi>



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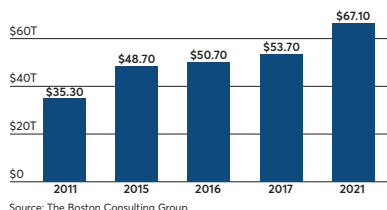
The Wealthy Are Getting Wealthier

Private wealth grew by 4.5% in the U.S. in 2016, up from 2% in 2015, according to a new study by the Boston Consulting Group. That's good news for advisers looking to build their client base. Better yet, the study also indicates that that wealth is expected to grow even faster over the next few years. Which client segment has the most potential in this growth market, and which asset class should advisers pay attention to? To see more of this story, type the following link into your browser: <http://bit.ly/2uvBlol>

GUIDE TO GROWTH

A positive outlook

By 2021, wealth is projected to nearly double 2011 levels.



Source: The Boston Consulting Group

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12-13

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2-4

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EDITOR'S VIEW

From the Ground Up

How advisers are blazing new trails in their careers, even if means saying goodbye.



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LEAVING ONE JOB FOR ANOTHER IS A HEADY MIX OF EXCITEMENT, adrenaline and jitters. Imagine making the transition after 33 years. That's how long ex-Wells Fargo adviser Stephen Spector spent in the same Boston office before breaking away to join Steward Partners, an independent firm affiliated with Raymond James.

Saying goodbye to colleagues, friends, well-established work protocols — and, potentially, valued clients — is daunting, says Senior Editor Andrew Welsch, who wrote our cover feature, "The \$600M Move" on the best practices of going independent.

"You say goodbye and moments later you're embarking on this whole new adventure," Welsch says of advisers' experience with the transition. "You've got a fresh office, with new colleagues and an entirely different back-office support system."

Welch tells me he was fascinated by the undertaking, particularly advisers' rush to retain clients. One planner he profiled made 150 calls to clients within 48 hours.

"It takes a lot of effort and involves a ton of paperwork," Welsch says. The look behind the curtains could be especially valuable for advisers, he adds, since "many might only make one move in their entire career."

The planners he interviewed told Welsch the switch was exciting and fulfilling. "They're building something from the ground up," he says.

BUILDING ON PRO BONO SUCCESS

This year's annual Pro Bono Awards, jointly sponsored by *Financial Planning* and the Foundation for Financial Planning, recognizes volunteers who are also building something from the ground up.

"The best planners are those who go into the profession to help people better their lives," says Senior Editor Ann Marsh, who wrote profiles of the winner and runner up. As a result, "Many of these advisers have learned that, by engaging in charitable work, they enhance their reputations in the industry, meet new prospects and often ultimately grow their businesses."

Welsch tells me that breakaway advisers are excited to explore new business models and new ways of communicating with clients — is it any surprise that evolution is mirrored in pro bono initiatives?

For example, this year's Pro Bono Award runner up is a team of students and professors at the University of Georgia who, among other initiatives, offer pro bono planning blended with therapy.

"This is a cutting-edge practice for the whole planning industry," Marsh tells me. "I think it is a bellwether for the kind of integrative planning approach I expect we will see more of in coming years." —*Chelsea Emery*



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DATA-BASED INSIGHT FROM *FINANCIAL PLANNING* AND SOURCEMEDIA RESEARCH

RETIREMENT ADVISER CONFIDENCE INDEX

Hints of Nervousness

Business conditions may have improved, but the possibility that markets may be overvalued is raising wealth managers' concerns.

DESPITE GROWING FEAR THAT SECURITIES prices are due for a correction, planners reported their business remains in expansion territory, according to *Financial Planning's* latest Retirement Adviser Confidence Index.

Advisers said that client inflows into equities rose, but that the pace of expansion slowed compared with recent months. The composite index – which tracks asset allocation, investment product selection, client risk tolerance, tax liability and planning fees, amid other factors – also registered a slower pace of improvement as it ticked down about 0.5 points to 53.6.

Readings above 50 indicate improving business conditions.

Many advisers and their clients are apprehensive that the bull market is close to running its course. "Clients tend to get nervous at an 'all time high' as they quickly remember 2007-2008," one adviser said.

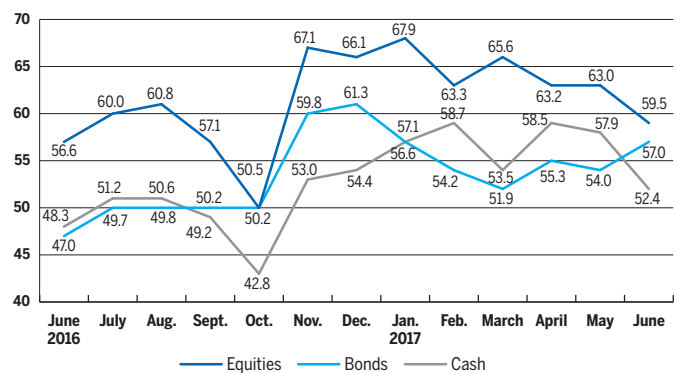
OPTIMISM

Despite some jitters, RACI components that track investments show that clients are keeping their nerve despite "a lot of headline risk" and "the craziness in Washington."

Some advisers highlighted the self-reinforcing effect of positive market performance.

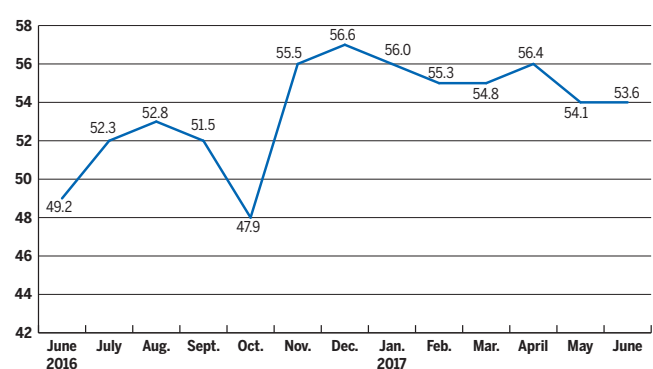
One planner said clients "expect higher rates of returns due to the recent success of the mar-

ASSETS ALLOCATED TO EQUITIES, BONDS AND CASH



Source: SourceMedia Research

RETIREMENT ADVISER CONFIDENCE INDEX



Source: SourceMedia Research

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kets.”

The pursuit of higher returns has translated into riskier investment profiles for some. “Several clients I met with for reviews expressed a desire to get slightly more aggressive with their investments,” one adviser said.

Client risk tolerance dropped about 3.8 points to 53.8, but remained in positive territory.

The index’s asset allocation components suggest that clients are making defensive maneuvers, however, with bond inflows rising 3 points to 57 while equity inflows slipped. “Market all-time highs caused more money flowing into bonds,” one adviser said.

Fees charged for retirement services rose 1.1 points to 54.7. However, advisers continued to focus on the fiduciary rule, with some chafing under the new administrative burden and blaming the regulation for confusion and fee compression.

The latest RACI includes the quarterly Retirement Readiness Index, which gauges advisers’ assessments of their clients’ preparedness. The index tracks factors that include retirement status, income replacement ability, dependence on Social Security and vulnerability to big economic shifts.

More than 60% of advisers said their mass-affluent clients (net worth of \$250,000 to \$1 million) would be able to replace their income for 30 years by the time they retire, compared with 77% of high-net-worth clients (\$1 million to \$10 million), and 83% of ultrahigh-net-worth clients (more than \$10 million).

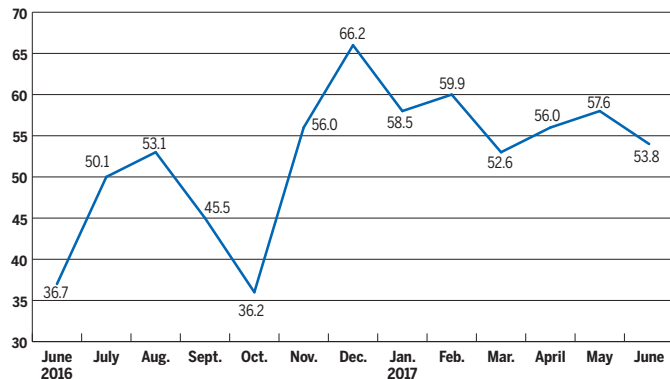
Almost 37% of advisers said their mass affluent clients’ retirement security is extremely vulnerable to a significant increase in health care costs, compared with 19% who said the same about their vulnerability to a crash in stock prices.

“Understanding medical expenses is a major topic of discussion with all clients,” one adviser said. “We see it as the biggest unknown to their financial plan.”

—Harry Terris

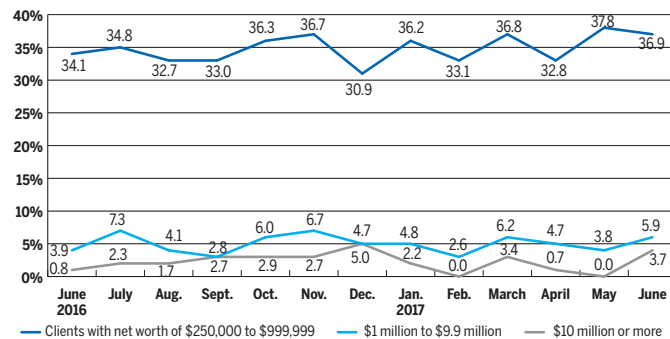
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PERCEIVED RISK-TOLERANCE LEVEL



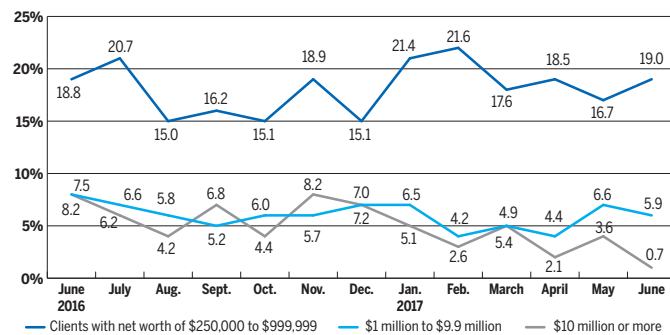
Source: SourceMedia Research

VULNERABILITY TO SIGNIFICANT INCREASES IN HEALTH CARE COSTS



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VULNERABILITY TO SIGNIFICANT DECLINES IN EQUITY MARKETS



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INDUSTRY INSIGHT **VERES**

Pssst — Try Acting Like a Fiduciary

The sales-first crowd is trying (desperately) to make sense of the new Department of Labor regulation, Bob Veres says.

"PSSST. HEY, YOU."

"What? Where are you?"

"Over here in the shadows. Come on over closer to this alley."

"OK... What can I do for you?"

"A bunch of us sales organizations are trying to figure out how to comply with these new Department of Labor fiduciary regulations. We all agree that it's crazy — putting the interests of the customer first, acting as a fiduciary with customers while we sell them nontraded REITs and high-commission annuities whose features even our reps don't fully understand — how do they expect us to change our business model on a dime?"

"Didn't the Labor Department start this process, complete with proposals and feedback, eight years ago?"

"That's what I mean. They sprung it on us without proper warning."

"And didn't they give you basically 18 months to comply?"

"We've been filing a bunch of lawsuits that prove conclusively that this is not nearly enough time for us to totally change our mindset to actually start caring about the welfare of our customers. We called you over because it's possible that our challenges will get tossed and we'll actually have to do this thing they want us to do."

"OK, so what do you need?"

"You talk to a lot of these so-called fee-only advisers who seem to think they are already complying with the DoL fiduciary's regulations. We want you to help us understand their secret."

"I don't think there's any secret —"

"So just tell us: How do they get away with recommending proprietary and high-commission products under the best interest contract exemption? Our attorneys are nervous that our top-selling investments may not be compatible with serving as fiduciaries when we make those recommendations to our customers."

"What, specifically, do the attorneys say is the problem with those investments?"

"Our proprietary funds have some of the highest expenses in the industry. And the annuities and nontraded REITs — let's just say our reps can make a great living if they can just find a few gullible buyers."

"And these expense ratios for your proprietary funds are exactly how high?"

"Toward the top of the upper quadrant. Some of that is 12(b)-1 fees that, we're told, are not specifically prohibited, but they get us all tangled up in this level fee thing the DoL insists on, where the compensation can't be higher for people who recommend

Our attorneys are nervous that our top-selling investments may not be compatible with serving as fiduciaries.

our funds than what we pay out if they recommend the much better options. It's really too complicated to understand."

"Maybe it doesn't have to be. What if you drop the 12(b)-1s? What if you do away with the commissions?"

"Then what kind of idiot would recommend our funds? Who would sell nontraded REITs? Would you recommend crappy products if nobody paid you to do it?"

"I think I have found your problem. Let's start with a kind of thought experiment. What would the world look like if you told your reps to always recommend the very best investments they could find?"

"You're kidding, right?"

"One of the secrets of these fiduciary advisers is that they make an honest effort to recommend best-in-breed, and go through a selection process that can be defended as sound and client-focused."

"Maybe that's the answer! You can help us rig up a process that will make it look as if our funds are superior to those really great funds. You might even be able to show that it makes sense for customers to pay 15% or more off the top and expect to get a high rate of return when only 85% of their money is invested in real estate projects."

"On the client's behalf?"

"OK, Let's back up. Those advisers you want to copy are actually working on behalf of the customer and not the product provider."

"We would never let our reps do that. It would put us out of business."

"Well, if your business model is to rake in as many dollars as possible without giving back a lot of value in return, I can see where that would be true."

"I don't see your point."

"The point is to put the interests of the customers first."

"Maybe we should move this conversation forward to the subject of hidden fees. How are those so-called fiduciary advisers hiding those excess fees?"

"They aren't."

"How can that be true? We spent millions of dollars on various tests, and every single time, the results came back the same. Whenever we actually disclosed those extra fees,

people objected."

"I didn't say they weren't disclosing them. I mean they weren't charging them."

"I suppose we could bury disclosures in the fine print."

"Would that be acting as a fiduciary?"

"Oh, right – the lawyers again. Maybe we could rename the charges. We could call them 'fiduciary fees.' I kind of like the sound of that. Don't you?"

"Look, did it ever occur to you that the whole point of the Labor Department rule was to get the full attention of everyone in the financial services industry, and give them a hard push to provide unbiased, helpful, client-centric advice to working people?"

"Spotting the difference."

"What are you trying to say?"

"It's been obvious for decades now that the future of the advice business is not trying to maximize commissions and sell junk products and engage in whatever self-dealing you can get away with."

"People don't want conflicted advice or a relationship that they can't trust, and they're getting better and better at spotting the difference. Can you not see that?"

"You're saying we should throw away our revenue model just because that's what people want? What are our reps going to sell under that model?"

"Not sell; recommend. Sell advice, not products. You have thousands of reps who genuinely want to do their best for their clients; ask them how to restructure your revenue model, and meanwhile dump the salespeople who aren't ever going to get it anyway."

"They're nothing more than a compliance and legal risk that will end up costing you more in legal fees than they'll bring you in sales revenues. Instead of fighting the fiduciary concept, or trying to change it into a sales-related activity, embrace the whole idea of fiduciary – which really is: Do your best for clients."

"Hey, you know, I like that. I really do. 'Do our best for clients' has a very marketable ring to it."

"Now if we could just figure out how to hide the commissions, I think we might actually be able to make this Labor Department thing work – hey, where are you going? We're still trying to work out the fine details here." **FP**

Bob Veres, a *Financial Planning* columnist in San Diego, is publisher of Inside Information, an information service for financial advisers. Visit financial-planning.com to post comments on his columns or email them to bob@bobveres.com. Follow him on Twitter at @BobVeres.



ELITE ADVISER **BOWEN**

Rules for Building Your Fortune

It's tremendously rewarding to help people make smart decisions about their wealth, John J. Bowen Jr. says.

IF YOU'RE LIKE MOST BUSINESS owners, you want to use it to achieve three key goals, according to research I have done with Russ Alan Prince, the founder of market research and consulting firm R.A. Prince & Associates.

1. Take care of loved ones. Ninety-four percent of business owners say that becoming wealthier means they'll be able to take care of their loved ones financially. Chances are, you share this goal with your clients.

2. Support important causes. More than 70% are dedicated to charity. Indeed, many advisers in our coaching programs are involved in charities. By amassing greater wealth, they're able to do more.

3. Change the world. About one in eight say they would like to change the world in a positive way. These may be audacious goals that only extreme wealth can address, such as ensuring clean water in certain regions or curing fatal diseases.

FOLLOW THE RULES

It takes discipline and focus to become seriously wealthy. Fortunately, there are some dominant, and persistent patterns – rules, if you will – that most successful business owners follow.

These seven money rules encapsulate the key mindsets, strategies and tactics that can potentially make you seriously wealthy. What's more, they can also help your clients.

1. Commit to extreme wealth. Many

advisers and their clients would like to be wealthier but haven't committed the time or effort needed. After all, doing so can come at the expense of something else important. Following this rule means having a clear sense that money is a critical objective.

Achieving tremendous wealth often means habitually prioritizing work and business dealings above personal and family concerns. If that's something you're not willing to do, that's okay. But what it means is that you will need to arrive at a lower number – leaving you with less wealth, but more time and more of the life balance you seek.

2. Engage in enlightened self-interest. For advisers, it could mean making a strategic decision about what kinds of clients to serve. Before deciding, advisers should run the numbers, i.e., quantify the revenue opportunities for each niche they would consider serving, and quantify the cost involved of serving each niche.

Skilled negotiation is another element of successful economic endeavors. Successful people always define their own line in the sand when negotiating, and try to assess the other person's line. They also seek to learn the other party's weaknesses that may be exploited. While a win-win is desirable, an "I win, you ... whatever" result is acceptable.

3. Put yourself in the line of money. Simply put, some endeavors are more fruitful and rewarding than others. For instance, positioning yourself to serve successful

Advisers should run the numbers for each niche they would consider serving, and quantify the cost involved of serving each one.

entrepreneurs is more likely to generate significant wealth for you than trying to work with inheritors, who tend to be less loyal to their advisers over time.

Following this rule means pursuing the fields and initiatives that have the utmost potential for outsize returns. This might mean focusing on a highly profitable niche market of affluent investors, such as owners of privately held businesses, family-owned operations and firms owned by accountants, and highly compensated professionals.

Consider that one-third of U.S. households with investable assets of between \$1 million and \$5 million are business owners, according to research by my firm, CEG Worldwide, and Wealth Engines. Fully three-quarters of people in the \$5 million to \$25 million range own businesses. And among the truly wealthy (\$25 million or more), nine out of 10 are business owners.

4. Pay everyone involved. The exceedingly wealthy never assume people are willing to work solely for satisfaction or fulfillment. Instead, they rely on generous compensation such as cash or equity to motivate those who help them advance their long-term goals. In an advisory practice, that means taking care of key employees. Give them a career track to grow as your business expands. It could also mean offering an equity stake in your company to those instrumental in helping you drive success.

5. Connect for profit and results. Highly successful advisers think about networking as a means to an end – finding resources that get them one step closer to their personal and professional objectives. Following this rule means maintaining a small but deep network of relationships that can lead power and influence, as well as friendship.

This form of nodal networking is characterized by a few, very powerful, highly

targeted relationships. For advisers, relationships with other professionals such as attorneys, accountants, insurance specialists as well as members of CEO groups and executive directors of associations can be hugely helpful in accelerating success. Networking efforts can be further amplified by joining high-end study groups, such as mastermind groups, consisting of other like-minded, success-driven advisers.

6. Use failure to improve and refocus. Rather than obsessing about lost opportunities, study your failures and do all you can to prevent repeating missteps.

Perseverance is crucial. When confronted by personal or professional disasters, the self-made super-rich express a powerful determination to keep going. As an adviser, some of your growth initiatives will prob-

ably fall flat – but kernels of insight about what to do better next time can come from those failures. One way to manage failure positively is to have a strong foundation and then

experiment with new ideas and strategies on the margins.

As an adviser, that might mean devoting 80% to 90% of your business to an ideal, highly profitable niche market, then branching out a bit into other new or emerging client niches in your area.

7. Stay highly centered. The wealthiest recognize what they do exceptionally well. Being highly centered means sticking to your plan, concentrating your efforts on your areas of expertise, and delegate other tasks and activities.

As an adviser, be extremely clear on your role in your firm and where you add the most value. For many, that means staying engaged as the rainmaker who brings in new business. Any other functions (from marketing to back office duties) should be delegated or outsourced. **FP**

Maintain a small but deep network of relationships that can lead to power and influence, as well as friendship.

Video

By applying these tactics to their practices, planners can improve their finances while also helping clients improve theirs.

<http://bit.ly/2ui9kXm>



IN PRACTICE
FOSS

Mastering Alt Investments

You can help your high-net-worth clientele invest in exotic categories, even racehorses and gold coins, while evaluating risk factors, says Kimberly Foss.

IF YOUR FIRM IS WORKING WITH high-net-worth clients, it's highly possible that at some point you will be asked to offer guidance about alternative investments.

Whether it's a hedge fund, real estate or a racehorse, it's important for advisers to know not only the upside potential of such activity, but also the particular risks and vulnerabilities.

Some investments are harder to advise on than others – think of rare coins, art, managed futures or derivatives contracts – but if you can, you distinguish yourself.

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onto something.**

For one, it's important to help client verify the credibility of the investment's source.

You need look no further than the headlines about forgeries of fine art to know the truth of the adage, "All that glitters is not gold." Even established specialists such as Sotheby's can get taken in (as recently as 2011, to the tune of \$10 million for a fake portrait supposedly by Frans Hals, a 17th-century Dutch master).

AN UNREGULATED ENVIRONMENT

Additionally, many alternative investments exist in an essentially unregulated environment, adding to the need for advisers and investors to thoroughly understand what they are paying for.

Alternative investments are also typically illiquid, and many types feature high minimum investment requirements. Some come with steep fee structures that make getting in an expensive proposition.

But one advantage of alternative invest-

ments actually arises from some of these same disadvantages.

Because of their lack of correlation with many asset types associated with traditional investments, they can provide a hedge against certain types of risks in other classes of assets.

This, of course, is what you will see touted on the financial cable networks by those hawking gold and silver; such assets are negatively correlated with the performance of stocks and bonds, and they also provide a classic inflation hedge.

Similar claims could be made for certain collectibles, selected types of real estate and certain commodities contracts.

Despite their typically high front-end fees, alternative investments often come with lower transaction costs, because of lower turnover.

In addition, because of their lower liquidity, it is usually best to view alternative investments with a longer time horizon.

Although they may carry high front-end fees, alternative investments often come with lower transaction costs.

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Profits on sales of holdings owned longer than 12 months are taxed at the capital gains rate, rather than as ordinary income; this is usually an advantage for investors in higher tax brackets.

If you have clients who are foreign nationals or domestic tax-exempt organizations, you should note that certain types of private equity partnerships can subject the investors to effectively connected income from actively managed businesses or trades within the private equity portfolio.

Similarly, tax-exempt entities investing in alternative assets should exercise caution that they do not subject themselves to unrelated business income tax. IRS Publication 598 contains additional information about how tax-exempt groups may avoid such complications.

It is also possible to hold certain types of alternative investments in self-directed IRAs and 401(k)s, though we do not typically recommend making them a cornerstone of anyone's retirement account.

Another publication, IRC 408(m), specifies the types and forms of precious metals, for example, that may be held in retirement accounts, along with the custodial method that must be used. (Typically, an approved trustee must maintain physical possession of the coins or bullion.)

PRACTICAL CONCERNS

What would you do if a client approached you to ask what she should do with the paintings she inherited from her father's estate? How would you go about getting a reliable valuation for the artwork? Where would you turn if you determine with your client that the paintings should be sold?

You might begin by going to a website such as ArtBusiness.com to get a preliminary idea, but it would be far better to cultivate a relationship with a reliable, knowledgeable art dealer or established appraiser.

To get started, you might wish to reach out to the Appraisers Association of America, which is one of the most respected trade organizations for those specializing in fine

and decorative arts (its website is www.appraiserassociation.org).

A qualified professional may charge a fee to perform the appraisal, but you and your client are much more likely to be able to have confidence in the results.

Many HNW individuals like to own actual gold or silver as a hedge against inflation or even more desperate circumstances. If you are working with such clients, what steps would you take to help them make their transactions as secure as possible? The most important advice is to deal only with a reputable precious metals dealer whom you have thoroughly vetted.

HOLDING PRECIOUS METALS

When we have clients who want to take physical possession of precious metals, we counsel them to have the assets shipped to our offices, and we have actually developed procedures for accepting the delivery.

We then ask our clients to join us there for the opening of the package. This gives our clients absolute assurance that what they ordered is what they are receiving.

We have also developed a list of security measures that we recommend to clients, including ideas for safe storage, actions to take in the event of a home invasion and other considerations.

Overall, we do not make alternative investments a focus of our work with clients, and for most advisers working with individuals or even small institutional clients this is likely to be the case.

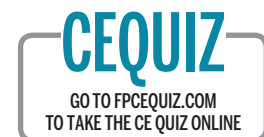
While some large institutional funds have begun allocating a small portion of their portfolios to alternative investments – typically less than 10% – this is not something we would recommend to a great many of our clients.

However, a client in a special situation may, from time to time, ask for your advice or help.

When that happens, do your homework, reach out to trusted professionals, carefully evaluate all the fees and help your client ask the right questions.

FP

Alternative investments' lack of correlation with many traditional investments means they may provide a hedge against the risks inherent in other asset classes.



Beware of Declining Fees

Despite record assets under management per adviser, wealth managers are seeing a slump in revenues.

BY SEAN ALLOCCA

DECLINING FEES MAY BE A GROWING CONCERN FOR financial advisers.

Fees as a percentage of assets fell for the first time in four years, even though average assets under management per adviser soared to a record \$92 million last year, according to new research by PriceMetrix, a research, consulting and software firm. Revenue per adviser also fell 1.4% in 2016 to \$583,000.

“Even advisers who have lowered prices aren’t necessarily gathering new business any more effectively than those keeping prices steady,” says Patrick Kennedy, chief customer officer at PriceMetrix.

Fee rates for households in the North American wealth management market for households with investable assets of \$1 million to \$5 million dropped to 1.13% from 1.16%. Fees

on new accounts fared worse. After slipping gradually since 2013, new-account fees sunk to 1.07% of assets last year.

SUBSCRIPTION SOLUTION?

One solution may be a transition to fee-based subscription models, Kennedy says. Two-thirds of clients are still using transaction-based fee models, according to PriceMetrix data, meaning there is still a lot of room for wealth management firms to make the switch.

“Fee-based is the preferred method of working for most financial advisers,” Kennedy says. “But, assets still remain in transaction models and that is something that we have to watch very closely.”

One of the leading contributors to the decline in revenue is a lack of customers, according to the report. Advisers added only 7.5 new household relationships on average in 2016, a new low, after years of decline.

Advisers have preferred to focus on older, higher-net-worth clientele, Kennedy says. Spending more time with fewer clients can be a positive for some, he said, since advisers have more time to spend with customers, leading to higher levels of client retention.

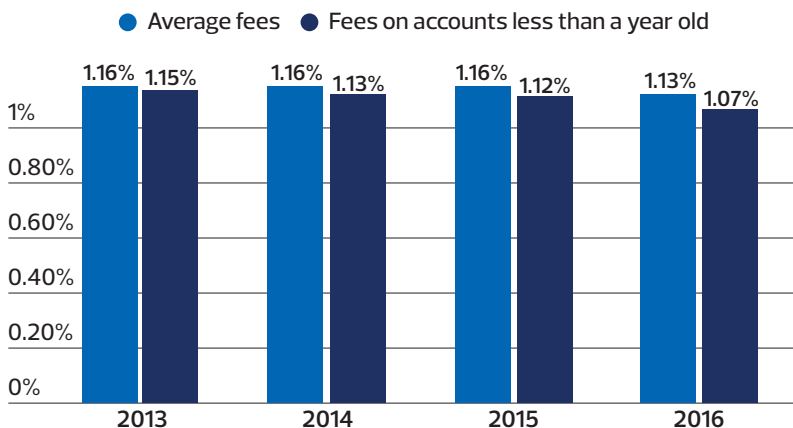
Despite last year’s revenue slump, Kennedy believes the most successful firms have focused on adding younger clients. “Growing new clients and assets – clients that are more likely to work on a fee basis – and maintaining price levels has helped grow revenue,” he says.

The top quartile of advisers added about nine new client relationships last year, according to the data.

FP

Falling Fees

Clients are paying less, especially on new accounts.



Source: PriceMetrix

Sean Allocca is associate editor of *Financial Planning*. Follow him on Twitter @sjallocca.



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Ratings are based on specific class performance of each fund. Current fund performance may be higher or lower, which may change a fund's star rating. Despite high ratings, funds may have experienced negative performance during the period. Performance may reflect a waiver of part of a fund's fees for certain periods since inception, without which returns would have been lower. A class share ratings no longer reflect sales charges. As of November 1, 2016, Morningstar will no longer provide ratings for load-adjusted share classes.

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Overall Morningstar Ratings™ as of June 30, 2017

All funds are Institutional Service Share Class. The number of funds represented for each time period is the same for a specific fund regardless of its share class.



NATIONWIDE GENEVA SMALL CAP GROWTH FUND

Out of 599 U.S. Small Growth Funds 3- and 5-yr rating 5 stars out of 599 and 533 respectively.



NATIONWIDE HIGHMARK SMALL CAP CORE FUND

Out of 646 U.S. Small Blend Funds 5-yr rating 5 stars, 3-yr rating 4 stars and 10-yr rating 3 stars out of 545, 646 and 389 respectively.



NATIONWIDE BOND FUND

Out of 856 U.S. Intermediate-Term Bond Funds 5- and 10-yr rating 4 stars and 3-yr rating 3 stars out of 767, 540 and 856 respectively.



NATIONWIDE INVESTOR DESTINATION MODERATE CONSERVATIVE FUND

Out of 400 U.S. Allocation 30% to 50% Equity Funds 3-yr rating 4 stars, 5- and 10-yr rating 3 stars out of 400, 348 and 240 respectively.



NATIONWIDE INFLATION-PROTECTION SECURITIES FUND

Out of 202 U.S. Inflation-Protected Bond Funds 3-yr rating 4 stars out of 202.



NATIONWIDE MID CAP MARKET INDEX FUND

Out of 368 U.S. Mid-Cap Blend Funds 3- and 10-yr rating 4 stars and 5-yr rating 3 stars out of 368, 220 and 328 respectively.



NATIONWIDE SMALL COMPANY GROWTH FUND

Out of 599 U.S. Small Growth Funds 3- and 5-yr rating 5 stars out of 599 and 533 respectively.



NATIONWIDE CORE PLUS BOND FUND

Out of 856 U.S. Intermediate-Term Bond Funds 3-, 5- and 10-yr rating 4 stars out of 856, 757 and 540 respectively.



NATIONWIDE HIGHMARK BOND FUND

Out of 856 U.S. Intermediate-Term Bond Funds 10-yr rating 4 stars, 3- and 5-yr rating 3 stars out of 540, 856 and 767 respectively.



NATIONWIDE BAILARD INTERNATIONAL EQUITIES FUND

Out of 595 U.S. Foreign Large Blend Funds 3- and 5-yr rating 4 stars and 10-yr rating 3 stars out of 595, 533 and 342 respectively.



NATIONWIDE DESTINATION 2045 FUND

Out of 158 U.S. Target-Date 2045 Funds 5-yr rating 4 stars and 3-yr rating 3 stars out of 117 and 158 respectively.



NATIONWIDE DESTINATION 2050 FUND

Out of 176 U.S. Target-Date 2050 Funds 5-yr rating 4 stars and 3-yr rating 3 stars out of 137 and 176 respectively.



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The funds listed above were selected based on fund availability and market relevancy.

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Please consult the most recent summary prospectus and/or prospectus for the respective Fund for more details.

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THE \$600



Advisers Stephen Spector, Ali Mandalinci, Beth Sweeney and Peter Frisch (l. to r.) broke away from Wells Fargo and UBS and stepped into a frenzy of activity in their first days at Steward Partners.

MILLION MOVE

A rare, inside look into how breakaway advisers navigate the herculean task of transitioning hundreds of clients to a new firm.

BY ANDREW WELSCH

The day adviser Beth Sweeney switched firms, she bid a tearful goodbye to Wells Fargo colleagues she'd known for a decade or more. Though she didn't have to travel very far to switch firms – her new office was actually in the same building complex – she still had something of a long journey ahead of her. Sweeney's mission: call over 150 clients within 48 hours to explain why she had left to join the independent firm Steward Partners Global Advisory.

"These were not quick phone calls," Sweeney says. "Some of these clients have been with me for 15, 20 years."

Over the course of a few days, Sweeney and two other teams in Boston opened Steward Partners' 10th office. The advisers, who left Wells Fargo and UBS, oversaw more than \$600 million in combined client assets, according to their new firm.

Their first hours were marked by a frenzy of activity. While advisers worked the phones, a transition team composed of more than a half-dozen transition specialists

assembled hundreds of red packets in a large conference room down the hall. Each packet was mailed overnight and contained information for clients on the new firm and its affiliation with Raymond James.

Sweeney, meanwhile, hit her goal. "I was so fried," she says.

'IT'S A FRENZY'

Switching firms can be an anxious time for advisers, since they don't know if their clients will indeed follow them to their new firm. Meanwhile, former employers do everything they can to retain the accounts.

"They'll go after their clients pretty heavily," says recruiter Michael King, who was not involved in Sweeney's move. "It used to be that some brokers would call and bad-mouth their former colleague, saying, 'Well, they were not servicing your accounts that well.'"

Though those kinds of dirty tactics are not as prevalent as they have been in the past, partially because of human-resources concerns, the atmosphere is still fiercely competitive, King says.

When the advisers David Karp and Paul Pagnato left Merrill Lynch to go independent with HighTower Advisors in 2011, they resigned at 8 a.m. on a Friday and had a car waiting to whisk them away to their new office.

"TO OWN PART OF THIS PLACE — IT CHANGES YOUR ATTITUDE IN TERMS OF WHEN YOU WANT TO COME IN OR LEAVE FOR WORK," SAYS STEWARD PARTNERS ADVISER PETER FRISCH.

"Within 90 seconds of our resignation, we were on the phone with our clients," says Karp, whose \$2.5-billion RIA is based in Reston, Virginia. "It's a frenzy. You want them to hear about it from you before your firm reaches



JOSH ANDRUS

"We could have been fully independent and had our own RIA and computers and office space, and you have to manage all that," says Steward Partners' Stephen Spector. "We didn't want that."

out to them."

FLAVORS OF INDEPENDENCE

The desire of Sweeney and her colleagues to move to an independent firm is a testament to the enduring appeal of non-wirehouse business models.

The independent space has grown at a much faster rate than the wirehouse channel has in recent years. The five-year compound annual growth rate for wirehouses' assets

is 4.9%, according to research firm Cerulli Associates. For the RIA and hybrid channels, that figure is 9.9% and 10.6%, respectively.

Moreover, the number of ways to go independent now runs the gamut

from operating a solo RIA to network models to independent broker-dealers. The variety is somewhat limited by what regulators say firms can and can't do, says Alois Pirker, research director at Aite Group. "But the nexus can vary greatly."

Pirker expects more creativity in business models to come — something that is particularly appealing to wirehouse advisers who don't also want to be burdened with the minutiae of building a firm from scratch.

"We could have been fully independent and had our own RIA and computers and office space, and you have to manage all that," says adviser Stephen Spector, who moved to Steward Partners' new office with longtime teammate Peter Frisch. "We decided we didn't want that."

Their team opted for Steward Partners because the firm offered greater independence and operates as a partnership, they say. Sweeney and Ali Mandalinci, a former UBS adviser who joined the office several days after

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from a weighted average of the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating metrics.

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AB Intermediate Diversified Municipal Portfolio was rated 5 stars among 181, 153 and 96 funds in the category for the three-, five- and 10-year periods, respectively.

AB High Income Municipal Portfolio was rated 4 stars against 145 and 118 funds in the category, for the three- and five-year periods respectively.

AB National Portfolio was rated 5 stars against 256, 224 and 150 funds in the category for the three-, five- and 10-year periods, respectively.

AB Global Bond Fund was rated 5, 4 and 4 stars against 312, 247 and 128 funds in the category for the three-, five- and 10-year periods, respectively.

AB High Income Fund was rated 5 stars against 596 and 471 funds in the category, for the three- and five-year periods, respectively.

AB Income Fund was rated 5 stars against 851, 750 and 538 funds in the category for the three-, five- and 10-year periods, respectively.

AB Concentrated Growth Fund was rated 3 and 4 stars against 1,306, 1,154 and 800 funds in the category for the three-, five- and 10-year periods, respectively.

AB Large Cap Growth Fund was rated 5 stars against 1,306, 1,154 and 800 funds in the category for the three-, five- and 10-year periods, respectively.

AB Emerging Markets Multi-Asset Portfolio was rated 5 and 4 stars against 629 and 429 funds in the category for the three-year period, respectively.

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them, echo that sentiment.

Plus, new hires get equity in Steward Partners. The attraction of having an ownership stake has helped Steward recruit more than 60 advisers since ex-wirehouse managers founded the Washington, D.C.-based firm in 2013.

'LIKE A GRADUATION'

Despite the appeal of greater independence and potentially higher pay, Steward Partners' newest recruits didn't find it easy to leave their old firms.

"That was tough," Spector says.

In his 33-year career, he had never switched firms. Spector and his partner Frisch, who also hadn't moved during his 22 years in the business, had strong ties to their former colleagues.

"I'd call it bittersweet, like a graduation," Spector says. "You are moving on to bigger and better things, but there's always a little sadness."

Mandalinci had switched firms before; he started his career at Merrill Lynch when he was 22 years old, but left for Smith Barney after the wirehouse took away his biggest client because it deemed him too young, he says. After Smith Barney merged with Morgan Stanley, he moved to UBS.

"YOUR SENSE OF URGENCY IS 'NOW, NOW, NOW,' BECAUSE IT'S YOUR BUSINESS. BUT CLIENTS ... DON'T HAVE THE SAME SENSE OF URGENCY," SAYS RECRUITER DANNY SARCH.

Still, he says he dreaded resigning from the Swiss firm. "I enjoyed UBS. It was a good firm. Real good people work there," says Mandalinci, who made his move to Steward a few days after the other advisers.

OWNING IT

Mandalinci and the other Steward Partners recruits say the firm's culture,

affiliation with Raymond James and partnership structure were particularly appealing.

As partners in the firm, new hires can partake in profit-sharing in their third year at the company.

In a sense, the structure reflects a different Wall Street era, when storied firms like Salomon Brothers were partnerships, not public companies. "I think to have the right priorities, you have to have skin in the game," Spector says.

Frisch also says that clients were quick to note that their new business cards now say "partner." He adds: "To own part of this place – it changes your attitude in terms of when you want to come in or leave for work."

Unlike HighTower and Focus Financial Partners – other high-profile independents – Steward Partners does not have private equity backing, something the firm's leaders say they have avoided intentionally.

"With private equity, you know what you are getting: a short time frame, typically three to five years, and a bunch of really smart people who will try to micromanage your business," says Michael McMahan, chairman of Steward Partners' board

and founder of Pine Brook Partners, a private equity firm specializing in the energy sector.

McMahan is not affiliated with Raymond James, and the BD, based in St. Petersburg, Florida, does not have an ownership stake in Steward Partners.

With big capital injections from private equity, HighTower and Focus Financial have been able to lure wire-

house breakaways and snap up RIAs. Those firms have notched impressive growth and have also been subject to regular speculation about a potential sale or IPO.

By forgoing private equity, Steward Partners executives say they avoid that pressure and can focus on steady growth within the Northeast, their primary target area.

"We're never going to open an office empty," CEO Jim Gold says. In other words, each new branch has to be economically viable from the start. And executives say they put in considerable effort to ensure that.

"In Albany, we were probably going up there for two years before we opened [that office]," Gold says of the firm's upstate New York location.

53 RED PACKETS

When an adviser moves from one firm to another, there's something of a cloak-and-dagger atmosphere because confidentiality is critical. In a twist, Spector and Frisch's team and Sweeney's team worked at the same Wells Fargo office but had no idea they were planning on the same move.

That was no accident. "We never reveal who we are talking to," says Greg Banasz, managing director at Steward Partners. "But we'll ask, 'Who would you never want to work with?'"

Departing advisers also need to maintain a level of secrecy because of the strictness of the industry's Broker Protocol and the litigation that may follow a move. (In January, for example, a FINRA arbitration panel awarded Wells Fargo more than \$23 million after Robert W. Baird lured away a group of Wichita, Kansas-based advisers who collectively oversaw \$1 billion.) Some brokers say privately that they don't even tell their spouse about their plans until nearly the last minute.

Not being able to get feedback from

clients about the intention to leave compounds the stress of a transition, says Karp, the ex-Merrill broker now affiliated with HighTower. "I lost sleep over it," he says.

Some firms have developed robust processes to reduce that stress and ensure clients can easily transfer accounts. Steward Partners has a team of specialists who begin prep work before recruits join. The specialists are on-site when new hires arrive; Raymond James also provides additional support. Steward Partners, which plans to add more offices, added two new staff members this year to help handle the work.

"A transition happens across all areas. It doesn't happen in a vacuum," says Valarie Margaritopoulos, head of field operations for Steward Partners; these changes have implications for administration, human resources and more, she says. In Boston, Margaritopoulos and her teammates assembled packets for clients in a conference room while simultaneously answering advisers' questions.

Combined, Steward Partners' new hires served more than 500 households before the move.

But that influx was far from the transition team's biggest challenge ever. Earlier this year, Steward Partners hired three Morgan Stanley teams to open a new office in Clearwater, Florida. Those recruits oversaw about \$700 million and served more than 1,200 households. To accommodate the volume of packets,



JOSH ANDRUS

When Beth Sweeney switched to Steward Partners, she ended up making phone calls to 150 of her Wells Fargo clients within the first 48 hours.

the transition team assembled some of them in other locations.

'NOW, NOW, NOW'

Typically, advisers switching firms take about 90% of their assets with them, say recruiters. But moving the clients with the adviser can take up to 90 days; a single client may have multiple accounts, securities-based loans and estate and trust planning needs.

"Your sense of urgency is 'now, now, now,' because it's your business," says Danny Sarch, a recruiter involved in one of the moves. "But clients do it in their own time. They have a vacation or a wedding coming up, and they don't have the same sense of urgency that the adviser does. That's why some clients move two or three or four months later."

Mandalinci, who serves a relatively small number of clients, says he was impressed with the transition team's process and diligence. Still, he admits

he had a little anxiety.

"If it was up to me, I'd take 53 packets and make 53 visits to each client," Mandalinci says. "But that would take months."

He left UBS on May 4, going directly to his new office. By midafternoon, he had called 20 clients. Nineteen agreed to move with him, and one was a maybe, Mandalinci says.

"That's one of the hardest things about deciding to make a move," he says. "There is a period where I can't do my job because I'm transitioning clients. So, in 60 or 90 days I'm looking forward to a return to normalcy."

In the meantime, he and the rest of the Steward Partners crew were pushing forward.

By 3 p.m. on the first day, Mandalinci was halfway through the list of clients he had to call. Stacked by the front door were 53 packets for overnight shipping, one per client. The UPS driver was due any minute. **FP**

Andrew Welsch is senior editor of *Financial Planning*. Follow him on Twitter at @AndrewWelsch.

Starting a Fee-Only RIA

From setting fees to dealing with compliance scares, veteran planners advise new RIAs on what to consider when launching a firm.

BY TOBIAS SALINGER

Starting your own practice takes time, money and some fraught decisions.

Conversations with seven advisers identified just some of the challenges they faced: What types of business models and technology should they use? How should they set fees? How long can a new firm expect to be unprofitable?

These are questions that an increasing number of planners are grappling with: The number of RIAs has jumped nearly 16% in the last four years to 12,378, according to the SEC.

Confronting these problems head-on has its payoffs, the seasoned advisers said in a series of panels at NAPFA's spring conference. New tools have made starting a firm easier, allowing planners to launch RIAs that fulfill their own visions.

Yet independent fiduciaries also face growing competition, according to Bob Maloney, a founding NAPFA member, who notes that many insurance agents now call themselves financial advisers. Fee-only advisers must sell clients on their greater value to sustain their new firms, he says.

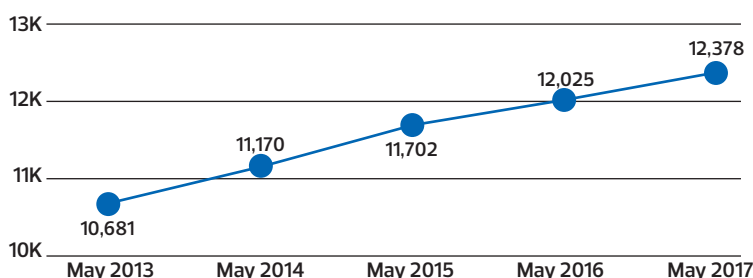
"Everyone wants to get away from the connotation of being a salesman," says Maloney, founder of Squam Lakes Financial Advisors in Holderness, New Hampshire. "What you're selling is trust and confidence. And if you can't do that, get the hell out of the business."

FEES AND SELF-WORTH

Most founders struggle with setting their fees, whether based on assets

RIAs on the Rise

The number of firms has grown 16% in the last four years.



Source: SEC

under management, hourly costs or retainers. RIAs may prosper under any model, but advisers must avoid going too low, says Peggy Kessinger, who started with a retainer of \$3,000 per year and now charges \$6,000.

"If you don't see 20% of your people leaving because of pricing, you're probably not charging enough," says Kessinger, principal of Cedar Financial Advisors in Beaverton, Oregon. "People value [your services] based on the way you value yourself, and that comes through in your pricing."

The Great Recession prompted more advisers to use retainers, says Frank Moore, founder of Vintage Financial Services in Ann Arbor, Michigan. A friend of Moore allowed clients to pick between AUM and retainers, noting many would pay less under a retainer model, he says.

"And yet none of his clients opted to go to the retainer," says Moore, who charges clients 1% of their total portfo-

lio. "What they told him was, 'I like the idea that when my portfolio goes up, you get paid more, and when it goes down, you get paid less.'"

COMPLIANCE SCORES

RIAs must register with either state securities regulators or, if they have more than \$100 million in AUM, the SEC. Firms like RIA in a Box provide registration services, while National Regulatory Services offers compliance training, notes Cindi Hill of Hill Compliance Advisors in San Diego.

"It's a really great class, and the junior advisers who have gone have come back scared. But they learned a lot," says Hill, who gave up her RIA to focus on compliance several years ago.

TECH 'STUPID-PROOFING'

Software for advisers like eMoney is akin to "stupid-proofing myself," says Patricia Jennerjohn of Focused Finances in Oakland, California. And

cloud-based remote meeting services, such as ScreenMeet, remove the need for most face-to-face meetings and physical office hours.

"My vision is to allow me to serve a broad range of clients and to do it profitably. That probably wasn't possible 10 years ago because of the technology," says Jennerjohn, who works from home and rents shared office space for client meetings.

Michael Solari of Solari Financial Planning in Bedford, New Hampshire, uses Wealthbox as his customer relationship management software. He employs Blueleaf to manage his workflow, Adobe Sign for easy signatures and Zapier, an automating app, among other software products.

"I spend a lot of time, because I'm a sole practitioner, finding ways to

make things easier," Solari says.

RIA founders must also decide whether they will provide investment management services, in addition to planning, at their new firms.

"It's a pretty important question when you're starting a practice, because it's going to define your trajectory in a lot of ways," says Mark Berg, founder of Timothy Financial Counsel in Chicago.

"My clients are not looking for a money manager; they're looking for an adviser," he says. "And there's a big difference."

Moore, who manages money and serves as his firm's CIO, says that such services are appealing to prospective acquirers of RIAs. The approach carries risks for AUM advisers, though.

"You get questions like, 'Why didn't

you beat the S&P this year?'" Moore says. "Now, we all get questions like that, but I think you get them more when you charge the AUM fee."

PROFIT PROPHECY

Advisers should plan on running their firms with no profits for at least the first three or four years if they are being realistic, Moore says. Startup capital is a must, and trying to set up a new firm on the cheap represents one of the most common mistakes, Jennerjohn says.

Kessinger says she felt at ease by the third year after she co-founded Cedar Financial.

"Once you get that flywheel turning, it's just the most satisfying profession that I can imagine," she says. "It's worth all that initial stuff." **FP**

Tobias Salinger is an associate editor of *Financial Planning*. Follow him on Twitter at @TobySalFP.

A Job or a Calling?

Here's how to create a firm culture that will appeal to excellent employees and attract ideal clients.

BY CAROLYN McCLANAHAN

Work is either a job or a calling.

Most people would love to have a calling, and the financial planning profession readily fits the bill for many.

Advisers have an opportunity to make a significant difference in clients' lives – work that can be emotionally rewarding. Financial services firms that focus on actually helping people while making a decent profit can create an incredible work culture. In recent years, there has been a large

Top 5 breakaway states by AUM per adviser

Nevada	\$600M
Rhode Island	\$500M
Indiana	\$459.8M
Minnesota	\$315M
California	\$267.7M

Source: Industry data, January 2014–February 2017

cadre of advisers leaving the wirehouse and broker-dealer world and going to independent RIAs.

Fiduciary standards and robo advisers are playing a small role. At the same time, clients have become savvy and are leaving non-fiduciaries in droves. Wirehouse advisers see there is a better way to help their clients, they want a change in culture, and the stars have aligned for them to jump ship.

In the past half century, readiness for retirement moved away from guaranteed pensions to the uncertainty of 401(k) plans. The need for financial

to ask how culture is created, communicated and maintained. If they plan to start their own firm, then they need to foster a healthy culture from Day 1. How is this done?

First, create the culture. Focus on characteristics of your organization that turn your job into a calling. At my firm, we have specific engagement standards that spell out how we act at all times. A few examples:

- **We have an open door policy with honest, direct and clear communication.** If something bothers employees, they need to share that information. If

and we learn from them. We agree to make each other aware of errors as soon as they are discovered. We do our best to minimize errors and immediately remedy errors that do occur. Our goal is to make the client whole.

The next step is to communicate the culture. New employees are given a copy of our engagement standards before they are hired and must initial each line when they take the job. The entire firm reviews the standards at least once a year, and occasionally we make updates. It is a living document.

One person in the firm serves as head culture keeper. If there is a lapse in our way of operating, the culture keeper's job is to call it out immediately and help craft a remedy. This shows how serious we are about our culture and conveys that our words have meaning.

“I DON'T KNOW” IS ACCEPTABLE BETWEEN STAFF MEMBERS. “I DON'T KNOW, BUT I'LL FIND OUT” IS AN ACCEPTABLE ANSWER TO A CLIENT.

advice flourished, and this presented the financial services industry with a huge opportunity. Ideally, advisers would help the public prepare for a secure retirement and make a nice profit along the way.

Stockbrokers and insurance agents became trusted advisers. Unfortunately, the companies they worked for took only half of the deal with America seriously. Making a nice profit took precedence.

Large companies sometimes sold clients expensive products that were not good for their future retirement. Firms did this with hidden fees, through the use of slick promises and advertising, and by training deluded advisers into thinking they were helping their clients. Incentives focused on sales, not client success.

FINDING A BETTER CULTURE

Advisers whom I've interviewed recognize they come from an unhealthy culture. When striking out, they need

there is a criticism of another employee or the way things are done, we listen to one another from a place of learning, empathy and goodness to resolve the situation. We do not speak behind others' backs and, if it does happen, it is understood this information will be shared with the employee concerned. We have short daily meetings to communicate about any issues.

- **All questions are good questions.** If employees are uncertain, they need to feel free to speak up. “I don't know” is acceptable between staff members. “I don't know, but I'll find out” is an acceptable answer to a client.

- **We are all valuable.** Our relationship needs to be re-evaluated if we ever stop enjoying or respecting one another. We are committed to living our lives from a place of joy and kindness, and hope to have long-lasting, healthy relationships with one another and all of our clients.

- **Mistakes are human.** We take full responsibility for any errors made,

CULTURE CORRECTION

Recent events at Uber laid bare the importance of cultivating the right kind of corporate culture. The company has suffered after revelations of bad business practices, attitudes of entitlement and rampant sexism.

A kind, purposeful and caring culture draws ideal clients and excellent employees. Clients want to know that employees love their job, since this translates to better service. Clients also feel good knowing they are affiliated with outstanding people.

Word gets around. Clients' talk about our culture has translated into referrals. We never actively ask clients for referrals. They ask if they can send prospective clients to us.

Independence is more than escaping a bad model of service. It is the perfect opportunity to create a firm that translates a job into a calling and transforms the lives of co-workers and clients who join you. **FP**



“Without this program, I don’t know where my girls and I would be. My financial planner helped me fix my credit, save over \$2,000 and buy my first home.

My family’s life is forever changed.”

– Angela R., a clinical nurse and domestic violence survivor

The Foundation for Financial Planning has provided over \$6.2 million in grants to nonprofits around the country, supporting efforts to create and expand free financial planning programs like the one that helped Angela achieve financial independence.

Join the network of planners powering pro bono financial planning for people in crisis or need. Become a volunteer or make a tax-deductible contribution at **FoundationForFinancialPlanning.org**.



**FOUNDATION FOR
FINANCIAL
PLANNING**

Powering Pro Bono Financial Planning



A FATEFUL ELEVATOR RIDE

A PIONEER IN PRO BONO PLANNING AND THE FOUNDER OF THE FPA'S NEW YORK CHAPTER, JUDY VOLKMANN ALSO HELPED LAUNCH A COLLEGE PROGRAM CONNECTING HUNDREDS OF FPA MENTORS WITH STUDENTS.

BY ANN MARSH

One day in 2012, an attorney named Thomas Chu stepped into an elevator with Judy Volkmann, the founder of the New York chapter of the FPA.

By the time he got out, Chu was on his way to becoming a CFP and following a new career path.

"It totally changed the course of my life," he says.

Ultimately, Chu's journey under Volkmann's tutelage would lead him to help a young man named Haidar Jamal Baba attend Columbia University as an undergraduate.

Years later, BlackRock would hire the Ghanaian immigrant in his current job as an iShares analyst.

If one day Jamal Baba realizes his childhood dream of becoming a leader in his home country, the help from Chu, spurred by Volkmann, will have played an integral role – and illustrates just how far-reaching a single pro bono planning engagement can be.

It also demonstrates how Volkmann, a quiet-mannered retired lawyer known for her ability to do much while saying little, has impacted dozens of planners and,

PRO BONO AWARDS: JUDY VOLKMANN

by extension, hundreds of college students.

For her groundbreaking pro bono contributions to students, to planners and to the profession of planning itself, Volkmann is the winner of the 2017 Pro Bono Award, jointly presented by *Financial Planning* and the Foundation for Financial Planning.

The foundation provides grants to support pro bono financial planning efforts around the country.

This year's runner-up award goes to a dynamic team of professors and students at the University of Georgia. (See page 38.)

To honor Volkmann's contributions, the foundation will give a \$5,000 grant to the MoneyWorks financial literacy program, which she helped to found in 2006.

MoneyWorks has provided one-on-one planning sessions to hundreds of students, as well as classes in financial literacy. It is administered through the Borough of Manhattan Community College in collaboration with the FPA of New York.

HISTORIC ROLE

It's hard to overstate Volkmann's impact on the planning industry's pro bono efforts.

A former public defender and estate attorney, now retired from her practice in New York City, Volkmann became a CFP to better serve her clients. "There's nothing like an estates attorney who has a CFP," she says.

Although Volkmann never worked as a planner, she spent her career working with the clients of planners who routinely sent her referrals.

And in 2000, Volkmann played a historic role in the FPA by incorporating its New York chapter. At the same



MICHAEL CHU

Ripple effect: Five years ago, Judy Volkmann encouraged Thomas Chu (right) to get a CFP, join the FPA and do pro bono work. Chu, in turn, helped Haidar Jamal Baba (left) get enough financial aid to attend Columbia University. Jamal Baba was then hired by BlackRock.

time, she founded a pro bono division of the chapter, the first in the nation.

Not only was it the first state-run FPA pro bono effort, it was also a precursor to the national FPA pro bono division. "She made a tremendous long-term impact on the FPA," says Anthea Perkinson, president of the FPA of New York.

The FPA's pro bono activities around the country have expanded to include an array of diverse programs,

fide profession," she adds.

Years after Volkmann started the FPA, she was playing poker with some friends and one of them challenged her to do something about American students' lack of financial literacy.

Volkmann answered the challenge by approaching Borough of Manhattan Community College administrators with a proposal for a program to teach students the basics of budgeting, student loans, debt reduction and

THE MONEYWORKS FINANCIAL LITERACY PROGRAM THAT JUDY VOLKMANN HELPED TO FOUND AT THE BOROUGH OF MANHATTAN COMMUNITY COLLEGE HAS PROVIDED PLANNING TO HUNDREDS OF STUDENTS.

including lobbying members of Congress to further the goals of independent planning, Perkinson says.

"I see a straight line from Judy's contribution to the growing perception of financial planning as a bona

the connection between finances and relationships.

MoneyWorks now comprises 16 classes for the students, many of whom are from families with incomes below \$35,000. FPA volunteers teach

PRO BONO AWARDS: JUDY VOLKMANN

the classes.

Every year, the program selects about 25 ambassadors from the student body. They commit to attending all of the classes and to persuading other classmates to join them.

This outreach has proved particularly effective, Volkmann and Chu say, with as many as 200 students at a time crowded into large meeting halls for classes.

Each ambassador also meets regularly with a member of the local FPA chapter for one-on-one planning.

GOING UP

The program paired Jamal Baba, the student, with Chu, an estate attorney who was working toward completing his CFP. Which brings us back to that elevator ride.

Chatting with Volkmann at a New York State Bar Association conference, Chu inquired about potentially buying her law practice. Unfortunately, Volkmann told Chu, she just had sold her practice to another. But she offered something else.

Chu said Volkmann told him: "Your consolation prize is I'll still give you the person who bought my practice as a mentor. But this is what you need to do. You are going to get a CFP. You are going to do pro bono work and join the FPA. You will be one of the very few trusts and estates attorneys in this community of planners, who are all trained to use your services."

"She's a person of few words, but she got it all in there," Chu recalls.

Chu was no stranger to big career shifts. He had left a career in one of the

top lay positions with the Episcopal Church, working with young people, for the law to better help people solve daily problems.

He followed Volkmann's directions and began studying for his CFP designation. Volkmann introduced him to people at the FPA. Eventually, Chu took over the FPA of New York's pro bono committee.

As a MoneyWorks mentor, Chu began advising Jamal Baba, who was looking to transfer to a four-year university. Jamal Baba had been admitted to Columbia University in New York.

The problem was that Columbia offered him an aid package that effectively punished him for the \$20,000 in savings he had earned by hawking ferry rides to the Statue of Liberty.

RUNNER-UP: A HIVE OF PLANNING ACTIVITY

A CLINIC AT THE UNIVERSITY OF GEORGIA HAS OFFERED FREE PLANNING FOR ALMOST A DECADE; NEWER INITIATIVES ARE EXPANDING THE TEAM'S REACH.

BY ANN MARSH

A clinic that serves the surrounding community by integrating free holistic financial planning with therapy sessions. A program that enables students to prepare 500 to 1,000 tax returns annually without charge. Planning seminars offered gratis to sororities, fraternities and other groups. A radio show that teaches the basics of smart financial management.

A hive of these and other pro bono financial planning activities is humming at the University of Georgia.

For their dedication and creativity across so many fronts, the 2017 Pro Bono Runner Up Award goes to the professors and students at the University of Georgia who volunteer their time offering services to people who could not otherwise afford them.

One of the university's older initiatives, the Aspire Clinic,

has provided free one-on-one planning sessions to hundreds of students and others in the community since 2009. "We target low-income families because they are priced out of fiduciary advice," Associate Professor Joseph Goetz says of the program, which he co-founded to give planning students the chance to work directly with nonpaying clients. "We've had clients who have had 20 sessions."

FINANCIAL THERAPY

While the clinic provides stand-alone planning sessions, the most effective ones integrate the financial component with traditional therapy.

"We are probably one of the first [academic] entities in the country to provide financial therapy," says Goetz, who believes that all good advisers, whether they have trained

Even while attending school full time, Jamal Baba had walked the sidewalks of lower Manhattan eight to 14 hours a day – before night classes and on weekends – trying to persuade sightseers to buy tickets. Though exhausting, the work often made him \$17 a ticket, enabling JamalBaba to save toward his education.

Chu, a graduate of Columbia Law School, accompanied Jamal Baba to the campus to meet with the director of financial aid.

"I said, 'You know, this student is being penalized for being entrepreneurial,'" Chu recalls telling the director. "You are giving him a horrible package. This money is not from his parents. It's from him."

Columbia came through with a full aid package.

'WHAT A FATHER WOULD DO'

"He did what a father would do for a son," Jamal Baba says of Chu. "He was sure to make sure everything was set financially and emotionally. I'd never had anything like that."

One of 10 children who grew up without electricity or running water in a village in northern Ghana, Jamal Baba lost his father to a sudden illness when he was 14. His mother died a couple of months later. Years later he moved in with cousins in New York, where he began studying and working.

Chu, who doesn't have children, says he gets fulfillment from passing on financial knowledge to people like

How one planner's pro bono work changed how she taught her daughters about money. See Selfie, page 56

Jamal Baba.

"You realize you are blessed with skills and gifts to give to other people," he says. "You don't have to be related."

Of the FPA of New York's 700 members, 135 volunteer for the pro bono division.

Volkman, who still runs MoneyWorks and whose dedication to pro bono work has spurred countless other successes, says her goal is to facilitate the work of others.

"Financial planning isn't just financial planning," she says. "It's getting involved with the clients whose lives you affect. Financial planners care, so they get involved." **FP**

to do so or not, "are practicing financial therapy."

With a new \$1 million infusion from a corporate donor and the university, the clinic is on the verge of a significant expansion to become "a world class training facility," says Sheri Worthy, head of the department of financial planning, housing and consumer economics in the College of Family and Consumer Sciences.

Through another outreach program, founded by Associate Professor Lance Palmer, planning students also earn advanced certifications from the IRS to provide tax preparation services for free – which can shield people in the community from predatory tax preparers selling them "inappropriate products," Goetz says.

NEW NPR PLANNING SHOW

Two other university figures have teamed up to launch a radio show, "Nothing Funny About Money," which airs on a local NPR station. Matt Goren, a newly hired adjunct assistant professor of financial planning, and planning doctoral student Michael Thomas co-host the program. Thomas also runs a for-profit practice, Modom Financial Services, which serves mass-affluent clients.



Matt Goren (l.) and Michael Thomas host a money show on an NPR station.

Worthy says she expects the program's reach to expand, especially if Goren and Thomas find underwriters. The university currently supports the show. In a separate effort, the radio partners teach free planning seminars in and near the city of Athens.

With its well-established clinic and new and growing programs, the academics and students at the University of Georgia hope to have an increasing impact on the planning profession in the coming years. **FP**

Ann Marsh is a senior editor and the West Coast bureau chief of *Financial Planning*. Follow her on Twitter at @Ann_Marsh.

Pitfalls of a Nonprofit Board

Advisers need to plan their nonprofit work carefully; the potential of having conflicts of interest may be greater than you think.

BY PAUL HECHINGER

ADVISERS WHO SEEK TO GIVE BACK TO THEIR community – while also attracting new clients – often consider serving on the boards of charities or nonprofits.

But just because the cause may be a worthy one doesn't mean that there aren't conflicts of interest or other pitfalls along the way. Advisers need to plan their work in this area just as carefully as they plan their clients' finances.

"Sometimes people think, 'Hey, it's for a charity; I'm not making money off this,'" says Dan Bernstein, the chief compliance counsel at MarketCounsel, a compliance consulting firm. "But it still rises to the level of having conflicts and supervision."

PROTECT YOURSELF

It's an area that is especially ripe for fraud, Bernstein explains, and it's important for advisers to take steps to protect themselves.

Larry Ginsburg, a planner in Oakland, California, cites a horror story about a colleague on the board of a charity whose head embezzled funds. Even though the adviser had recommended that all major transactions require two signatories, the board didn't accept his recommendation – the signature of the embezzler was the only one needed. Despite the adviser's explicit warnings, the board blamed him – and filed a complaint against him.

Now Ginsburg counsels advisers to protect themselves first. That means being alert to the possibility of worst-case scenarios and taking precautions to avoid them.

For one, advisers should consult their firm's compliance officers before joining a group's board, to help define and clarify the guidelines.

The biggest dangers relate to situations in which their roles as directors or trustees of a charitable organization might create the potential for advisers to direct assets to themselves or their firm.

"Don't get into charitable work – don't get into positions on the board specifically – to try to direct money to your



ADOBE STOCK

own business," says Martin Schamis, head of wealth planning at Janney Montgomery Scott. "That's the sort of thing that gets you into trouble."

Paul Auslander, the director of financial planning at ProVise Management Group in Clearwater, Florida, agrees. "You can't get on the board and try to pitch their 401(k)," he says. "You have to remove yourself. You can review it as part of the finance committee, but you've got to bid it out and have other entities do it."

Auslander adds that some compliance officers are against allowing advisers to act as treasurers or in any money-handling role requiring finance-related decisions.

AN OBVIOUS CONFLICT

Never serve on a nonprofit's board at the same time as you are managing money or giving investment advice to that board. It may sound obvious, but sometimes distinctions can be blurred, especially if the organization is small or informally run.

For example, other board members may start asking a board member who is also an adviser occasional questions

about investments or cash flow management, says Chris Stanley, general counsel for Loring Ward Holdings, a firm in San Jose, California, that consults with and advises other RIA's.

"First, it's once a quarter; then it becomes once a month; then once a week," he says. "Then, it evolves into the adviser, rather than just being a normal board member, effectively providing financial or investment advice on an ongoing basis."

This might create difficult situations. "It could raise questions about what are the rights and obligations of each party," he adds. "What happens if the investments go south? Does the adviser get blamed?"

If an adviser's charitable activities are in any way related to a client's charitable activities or intertwined with them, Stanley says, the line between personal and business activities can "get very blurry."

Even if a client is the one who brings up the idea of donating to a charity that he's involved with, Ginsburg tells them that they need to know that he cannot in any way encourage them.

'GOING TO HAVE A PROBLEM'

Some conflicts may be widespread but not so obvious. Auslander points to the not uncommon situation in which advisers serve on homeowners' associations.

"There's the poor schmuck who's out there helping his community by trying to make sure that people haven't messed up their lawns," Auslander says. "If he didn't list it on his outside business activity form, and the broker-dealer picks up on it through other means – and, believe me, they're pretty creative in finding things out – that guy's going to have a problem."

Being on a co-op board is even more dangerous, Auslander adds, because "a co-op board has real power."

Most advisers say that such problems can be avoided with careful planning and disclosure and that the extra effort is worth it for the personal satisfaction that comes with the work.

It's important for advisers to remember that they can provide important services to nonprofits, Schamis says. They can help when looking to select investment partners or advisers, or in looking for assistance in developing investment policy statements, as long as they recuse themselves if there's a potential conflict.

Advisers can also play helpful roles in monitoring expenses and investments and providing oversight, Schamis says, "making sure that the nonprofit you're a part of has selected a really good investment adviser to work with."

He adds, "Your expertise is very valuable as an adviser to these boards, but typically it's as a representative of the board, not as the board's financial adviser."

SERVE, DON'T SELL

The most important thing, advisers say, is to get involved for the right reasons – to give back to your community and not just to fish for prospects.

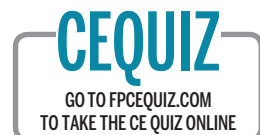
"Frankly, everybody knows that most people get on boards to meet people and network," Auslander says. The key, experts say, is that you don't go into charity work consciously scouting for business. Be content in knowing that if people meet you in the context of the nonprofit and they're impressed with your work and your commitment, they'll probably remember you.

"That's a skill you develop over the years," says Auslander, who is vice chairman of the Clearwater Marine Aquarium. "Eventually, you move up the ladder, and you become someone they think they need to know."

There's definitely a benefit in terms of publicity, visibility and opportunity for advisers who serve on nonprofit boards, but they should consider it as "an unintended benefit," says Ginsburg, who recently completed a third term on the board of directors of the Alameda County Community Food Bank.

"If you don't have charitable intent, don't do it," he says. "It's that simple." **FP**

The first step advisers should take is to consult their compliance officers to define and clarify guidelines for the relationship with a nonprofit.



Paul Hechinger is a freelance writer in New York. Follow him on Twitter at @PaulHechinger.

Managing Clients' Cash Cravings

New research suggests we're hardwired to crave liquid reserves. Advisers can accordingly help clients adjust their portfolios to enhance happiness.

BY MICHAEL KITCES

IN INVESTING, CASH IS GENERALLY VIEWED AS something best avoided or minimized. Holding some may be necessary for basic liquidity needs, but the classic investment strategy is to keep as little on hand as possible and to put the rest to work on long-term goals.

Recent research, however, suggests that holding cash appears to improve our feelings of financial well-being and life satisfaction. And this research has ramifications for the entire advisory industry. If clients actually feel happier when they hold more cash, perhaps their portfolios should be adjusted accordingly.

That's not to suggest cash is king. But paradoxically, this strategy might actually help clients to feel better about staying invested for the long run.

HAPPINESS IN THE BALANCE

The old saying goes, "Money can't buy happiness," but new research suggests happiness is materially impacted by how we spend money. Furthermore, our life satisfaction and emotional well-being seem to be correlated with having greater wealth and a higher income – at least up to an annual level of roughly \$75,000.

Looking at absolute levels of income and wealth, however, may obscure nuances in the relative impact of how those dollars are earned and held. For instance, Hersh M. Shefrin and Richard H. Thaler, known for their studies of behavioral economics, have found that people mentally earmark their dollars into three types of buckets – current assets, current income and future income – and that not all of those bucket allocations contribute equally to our happiness and emotional well-being.

To test this, a recent study by academ-

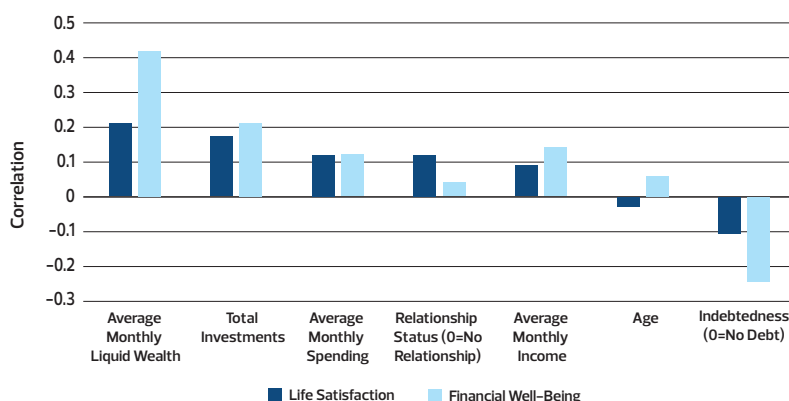
ics Peter M. Ruberton, Joe Gladstone and Sonja Lyubomirsky analyzed bank accounts, income and spending of 585 bank customers in the U.K. – average age 37 – and then surveyed those customers to measure their satisfaction with life and feelings about their financial well-being. Additionally, the authors gathered information about their subjects' other external investment accounts and debts, as well as their age, employment and relationship status.

The results revealed that the amount of someone's liquid wealth – that is, the value of checking and savings accounts – was correlated with their self-reported financial well-being and life satisfaction. In fact, liquid wealth had a stronger relationship to those factors than income, spending, investments or indebtedness.

Even more important, the between liquid wealth and measures of satisfaction and well-being remained – even after controlling for all the other financial variables, age, employment status and relationship status.

Notably, having cash on hand was not directly contrib-

The Correlation Connection



Source: "How Your Bank Balance Buys Happiness," Ruberton, Gladstone & Lyubomirsky, 2016

uting to life satisfaction per se; instead, liquid wealth directly (and positively) impacted perceived financial well-being, and it was that improvement that subsequently led to an improvement in life satisfaction as well.

Nonetheless, the researchers' bottom line is striking: A buffer of liquid cash available in checking/savings accounts, regardless of wealth or income, appears to confer a sense of security, which in turn is associated with positive feelings of financial well-being and more life satisfaction. Or stated more simply, wealthy people with very little in cash may still feel more financially distressed than poor people with relatively more cash.

CASH CAVEATS

While one might interpret the conclusions of Ruberton and his colleagues as validation for investors who feel better holding substantial cash, the study did find a diminishing effect. That's because the positive correlation was actually between life satisfaction/financial well-being and the log-transformed balance of liquid wealth.

On a lognormal scale, each increasing step in liquid wealth represents a 10-times increase in the actual account balance. In practice, going from \$1 to \$100 would feel as beneficial as going from \$100 to \$10,000, which in turn would feel as beneficial as going from \$10,000 to \$1 million. Which in turn means going from \$1 to \$10,000 would feel drastically more beneficial than going from \$10,000 to \$20,000.

On the other hand, not everyone's improvements in financial well-being – and the transition to diminishing marginal benefits – would necessarily have the same thresholds. Liquid \$10,000 should be treated as an inflection point – beyond which lurks dramatically diminishing returns on financial well-being and life satisfaction.

It may be that more affluent households have a higher demand threshold for cash. Alternatively, because they have other investment assets, perhaps the affluent maintain lower demand for cash. There may also be variances in individuals, where some people may simply have a higher proclivity toward holding cash, and others lower.

It's also important to note that a correlation is just that: a co-relation between two factors. People who are optimistic about life's opportunities may simply be more likely to hold cash in order to have it available to spend on those opportunities.

Alternatively, perhaps more financially competent and confident individuals are more likely to apply their knowledge by holding a healthier level of cash in emergency reserves. This would mean it's actually their financial competency leading to both higher cash balances and greater financial well-being.

These caveats notwithstanding, the idea that holding greater cash reserves could be a causal factor that leads to better feelings about one's own financial well-being certainly has face validity. And for many advisers, it should resonate with the real-world demand of many clients to sometimes hold substantial cash balances in their checking and savings accounts.

To some extent, this may simply be reflective of their financial realities. Those who have little or no cash don't just express greater distress about their financial well-being; they're arguably more likely to be in actual distress, as extremely low cash balances suggest the household lacks even a healthy emergency reserve and may already be struggling with contingencies it can't afford.

And we already know that consumers react more negatively to decreases in wealth or spending than they do positively to increases.

LOWER FINANCIAL WELL-BEING

Thus, it makes sense that those struggling to maintain their standard of living, and are intermittently experiencing decreases in spending capabilities, would have materially lower financial well-being compared to those who are wealthier with ample reserves to ensure household stability.

The key point of this research, however, is that greater levels of liquid wealth were associated with improvements in financial well-being – regardless of income or wealth levels. In other words, it doesn't appear to

Wealthy people with very little in cash may still feel more financially distressed than poor people with relatively more cash.

matter if the household actually needs more emergency reserves or not. There is still an improvement in financial well-being when the household increases its liquid wealth.

This shouldn't be entirely surprising, as our entire banking system is predicated on consumers demanding more liquidity than they actually need. It's why banks can conduct long-term lending using short-term deposits.

And the research on mental accounting had already suggested that this would be a likely part of the hierarchy of retirement income needs for a retiree. But the Ruberton study affirms that its scope is broader, as the same effect occurred despite the average participant being just 37 years old, and thus presumably still far from retirement.

Nonetheless, from the classic investment perspective, the desire to hold substantial amounts of cash is both unnecessary – as long as other investment holdings are reasonably liquid – and outright counterproductive given the traditionally low, and currently near zero, yield on cash and cash equivalents.

An inclination toward holding cash is typically viewed as an investment mistake, and something the adviser can rectify by putting the cash to work. Yet this new research suggests that fully deploying a client's cash reserves may actually exact an emotional toll, and one that isn't necessarily offset – mentally and emotionally – by the greater returns that may ensue.

Viewed another way, keeping a substantial cash balance isn't so much an inefficient investment decision as it is a decision to buy more happiness.

CURBING THE CRAVING

Still, this raises the question of just how cash-like an individual's liquid wealth must be in order to satisfy the mental demand for current assets. The researchers found a relationship between financial well-being and the balances of savings and checking accounts, so physical cash on hand isn't a requirement. But would other, slightly less liquid investments, like bonds, satisfy the

urge? Could easily liquidated stocks and ETFs slake the need? Might the adviser frame certain investment assets as current assets to make the client more comfortable with holding them in lieu of cash?

Similarly, what about other liquidity alternatives, such as debt – for example, a revolving credit line, a home equity line of credit or a standby reverse mortgage for a retiree? Might one of these meet the investor's need for current assets?

Anecdotally, the answer appears to be no, given it's not uncommon for consumers to accumulate emergency savings that earn nothing, while also still holding unfavorable debt, such as balances on high-interest credit cards. This suggests that the desire for cash is so strong it's not enough to use it to pay down debt and then just re-borrow later. We want to actually have the liquid wealth.

HOLDING COMFORT CASH

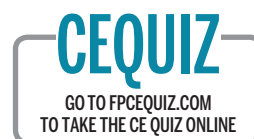
In the extreme, it's even conceivable that persuading clients to get out of cash could make them more likely to panic in volatile markets, and conversely that encouraging clients to hold enough comfort cash might make them more willing to ride out times of uncertainty. Again, it's not because they need the cash, but because it satisfies their need to fill the current assets mental bucket.

On the other hand, where the cash is held is likely to matter as well. To the extent that the desire for cash is a desire to fill the current assets bucket of the mental accounting framework, holding the cash in an investment account may not scratch the itch. This in turn further opens the door to adviser technology solutions that help manage and maximize cash yields.

But the bottom line is to recognize, in a world where human beings are not always perfectly rational, that the optimal pure investment strategy may not improve a client's sense of financial well-being. Perhaps it's time to stop treating cash like a problem to solve and more like a client's psychological need to be satisfied.

FP

Choosing to keep a substantial cash balance isn't so much an inefficient investment decision as it is a decision to buy more happiness.



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Should I ... Report Elder Abuse?

Sometimes, a planner is the first to notice discrepancies in a client's accounts, but family dynamics can muddy an otherwise clear situation.

BY INGRID CASE

OLDER AMERICANS ARE SO OFTEN VICTIMS OF financial abuse that the National Council on Aging estimates it costs the elderly \$36.5 billion annually.

Sometimes, planners are the first to notice and they must decide whether to report the problem to the authorities. Making the call is simple when the thief isn't related to the client. But when the miscreant is a child or grandchild, family dynamics can muddy an otherwise clear situation.

Rick Kagawa, a planner at Capital Resources & Insurance in Huntington Beach, California, called the police when a client's gardener stole from her. The client lost about \$3,500 to the man, who eluded arrest. Her family, however, took the report as a call to arms, working with Kagawa to hire a caregiver and bookkeeper for the client. "She doesn't handle money anymore," Kagawa reports.

A DISHONEST GRANDSON

When the thief is a family member, though, it's a tougher call. Kagawa had another client who lost about \$450,000 to a dishonest grandson. He called the police only when alerting the client's family failed to stop the theft. "Before that, I held off because the family wanted to deal with it themselves," Kagawa says.

Most families prefer to deal with intra-familial financial abuse privately, agrees Quentara Costa, a planner at Powwow in North Andover, Massachusetts. "It's a fine line, and family dynamics come into play," she says.

No planner wants to see repeated theft, but an elderly parent might be very upset to see a son go to jail for talking her out of \$1,000. "If they don't want the theft to be a big deal but they do plan to address the problem, that's fine," Costa says. "You don't want to cause the family unnecessary stress and strain."

The CFP Board encourages but doesn't require planners to report suspected elder abuse. If the family doesn't take



steps to protect a client, the planner should report the problem to the police or other authorities that handle reports of suspected wrongdoing against a vulnerable person, elderly or not.

The worry that an innocent person will end up in jail shouldn't prevent an adviser from reporting legitimate suspicions, Kagawa says. "It's not your job to be judge and jury," he says. "If everything is fine, the police won't do anything." (A proposed federal law, the Senior Safe Act, would remove any liability a planner might face by reporting.)

The suspect may not end up in jail even if there is a real issue. Steve Branton, a senior planner at Mosaic Financial Planning in San Francisco, found that out when a client's best friend told him that she thought her son was trying to take control of her assets.

Branton's client called state authorities about the situation, and the agency interviewed the woman's son. "That put the son on notice that he was on someone's radar, and they've had no problems since," Branton says. **FP**

Ingrid Case, a *Financial Planning* contributing writer in Minneapolis, is a former senior editor for *Bloomberg Markets*. Follow her on Twitter at @CaseIngrid.

PORTFOLIO

ALSO IN PORTFOLIO: P. 49: The Struggle to be Simple

Growth vs. Value Debate Derailed

A long-running argument might yield a different conclusion depending on which index provider you are using as a performance benchmark.

BY CRAIG L. ISRAELSEN

THE ARGUMENTS OVER INVESTING FOR GROWTH versus value can sometime remind advisers of a water cooler quarrel. Proponents of each approach come armed with their own compelling data and analysis. But like many spats, a simple, surprising piece of evidence can quickly derail the argument. In this case, it's the fact that the performance of both growth-oriented U.S. equity indexes and value indexes are strikingly different depending on which index provider you choose to use.

As a case in point, we can document a significant value premium over the past 19 years when using Morningstar U.S. equity indexes, but then see it disappear when using S&P U.S. equity indexes.

As you will see, this discrepancy among index providers can be central to the debate. Interestingly, it also emerges as a separate issue that illustrates the challenges in attempting to measure any aspect of our investment markets.

THE LARGE-CAP SECTOR

First, let's consider the difference in the 19-year average annualized return from 1998-2016 for three large-cap growth indexes as shown in the table "The Growth Versus Value Conundrum." The 19-year return of the Morningstar U.S. Large Growth Index was 3.88% whereas the Russell 1000 Growth Index had a return of 5.76%. The S&P 500 Growth Index did even better, with a 19-year average annualized return of 6.37%. (The reason for using the 19-year period is that several of the growth and value indexes in this analysis began in 1998).

The difference between a return of 3.88%

and one of 6.37% is a whopping 249 basis points. Let's put that into perspective in terms of money growth over 19 years. A \$10,000 deposit with a 3.88% 19-year return would grow to \$20,611. By comparison, if the money grows at 6.37%, the ending balance will be \$32,326 – a difference in appreciation of \$11,715.

The Growth vs. Value Conundrum, 1998–2016

The 19-year average annualized return of growth and value indexes using different index providers.

U.S. Large-Cap Indexes	Growth	Value	Large-Cap Value Premium
Morningstar U.S. Large	3.88	6.11	223 bps
Russell 1000	5.76	7.07	131 bps
S&P 500	6.37	6.30	-7 bps
Large-Cap Mutual Fund Category Average*	6.77	6.91	14 bps

U.S. Mid-Cap Indexes	Growth	Value	Mid-Cap Value Premium
Morningstar U.S. Mid	6.52	9.61	309 bps
Russell Midcap	7.52	9.45	193 bps
S&P Midcap 400	10.27	10.21	-6 bps
Mid-Cap Mutual Fund Category Average*	8.56	9.16	60 bps

U.S. Small-Cap Indexes	Growth	Value	Small-Cap Value Premium
Morningstar U.S. Small	5.58	10.06	448 bps
Russell 2000	5.97	8.66	269 bps
S&P Small Cap 600	9.23	9.39	16 bps
Small-Cap Mutual Fund Category Average*	8.80	9.59	79 bps

* Using the oldest share class to avoid overrepresenting mutual fund with multiple share classes
Source: Steele Systems Database, calculations by author

Thus, if you are evaluating U.S. large-cap growth stocks' performance over the past 19 years and you are using one of the three major index providers, your opinion might be very different based on whether Morningstar indexes or S&P indexes were used.

We see less of a performance discrepancy among the three large-cap value indexes over the past 19 years. The 19-year return of the Morningstar U.S. Large Value Index was 6.11%, the Russell 1000 Value was 7.07%, and the S&P 500 Value Index had a return of 6.3%.

But, more to the point of this article, there was a distinct value "premium" (higher level of performance in the value-oriented index) in the large-cap U.S. equity indexes from Morningstar – 233 basis points to be exact. By comparison, the Russell 1000 Value Index outperformed the Russell 1000 Growth Index by 131 bps. Interestingly, when comparing the S&P 500 Growth Index and the S&P 500 Value Index, we observe no value premium over the past 19-year period. In fact, there was a 7 bps growth premium.

Also reported in the table is the "category average" performance between growth mutual funds and value-oriented mutual funds. In the large-cap group, there is a very small value premium.

Admittedly, these performance figures are messy in that mutual funds (as opposed to indexes) can shift their allegiance between growth and value over time and/or fluctuate between large-cap and mid-cap holdings and thus end up in different categories from year to year. In addition, there is survivorship bias, meaning there is a tendency for poorly performing funds to go out of business.

Despite such potential issues in the category averages, we observe a slight value premium of 14 basis points among actual investable U.S. equity large-cap mutual funds.

(On a technical note, the category averages in the Steele Systems database utilize only the oldest share class of mutual funds that have multiple share classes. By doing so, the performance of multiple share-class funds is not overrepresented in the category average performance figures.)

We observe a similar outcome among

mid-cap growth and value indexes. There is a pronounced value premium of 309 bps between the Morningstar U.S. mid-cap indexes, a smaller value premium of 193 bps between the Russell mid-cap indexes and no value premium for the S&P mid-cap indexes. Clearly, the logic and design of growth versus value indexes is subject to different interpretations by the various index makers.

DRAMATIC DIFFERENCE

Not only that, the difference among mid-cap growth indexes is also dramatic. We observe a difference of 375 bps between the Morningstar U.S. Midcap Growth Index and the S&P Midcap 400 Growth Index over the past 19 years. This almost makes you wonder if they are measuring the same thing.

Using the category average, we see a 60 bps value premium among mid-cap mutual funds over the past 19 years. Certainly, in the years from 1998 through 2016 there were periods when growth outperformed, such as during the last gasps of the tech bubble in 1998 and 1999.

But, over the entire 19-year period, U.S. equity mid-cap mutual funds with a value orientation produced a slightly higher return on average than U.S. equity mid-cap growth mutual funds.

THE SMALL-CAP SECTOR

Among small-cap indexes the same trend continues. The performance of the S&P Small Cap 600 Growth Index was significantly higher than the small cap growth indexes at Morningstar and Russell. The performance differences among the three value indexes were, by comparison, much smaller.

As for the value-versus-growth differences within a family of indexes, there was a pronounced value premium of 448 bps between the Morningstar U.S. Small Cap Value Index and the Morningstar U.S. Small Cap Growth Index.

There is also a significant value premium of 269 bps between the Russell 2000 Value Index and the Russell 2000 Growth Index. And, for the first time, a faint value premium of 16 bps shows up between the S&P Small Cap 600 Value Index and the S&P Small Cap

We can document a significant premium for value stocks over growth stocks in the past 19 years when using Morningstar indexes, but then see it disappear if we use S&P indexes.

600 Growth Index.

As measured by the category average, we see a 79 bps value premium among small-cap mutual funds over the past 19 years. In the small cap space, a value premium seems indisputable over the long haul.

INDEX MAKER DIFFERENCES

The performance differences among the three index makers – Morningstar, Russell, S&P – are accentuated when comparing their growth indexes.

The S&P growth indexes had the highest 19-year return in all three sectors: large-cap, mid-cap and small-caps.

But performance is more similar when comparing values indexes among the three index creators, and the top results are spread through all three. Over the past 19 years, Russell's value index had the best performance among large caps, S&P had the best performance among mid caps, and Morningstar had the best performance among the small-cap value indexes. In terms of the performance of its indexes, S&P owns the growth space, but not the value space.

WHY DOES THIS MATTER?

There is an interesting subplot in this analysis which has to do with debate about whether active management funds or passive management funds are superior.

Advocates of index-based investing – passive management – often refer to active-versus-passive research that is conducted under the aegis of SPIVA (S&P Indices Versus Active). SPIVA research examines how actively managed funds perform against their benchmarks, and those benchmarks are S&P indexes.

Note that no one can actually invest in an index and that indexes do not reflect the impact of an operational expense ratio. Thus, the first problem is that indexes do not have expense ratios, whereas actual investable funds do – whether they are actively or passively managed. I would argue that the benchmark of any fund should be invest-

able, not an index that no one can actually invest in.

The second problem is that S&P indexes tend to have higher returns than Morningstar or Russell indexes – particularly among growth indexes. This essentially creates a higher bar for actively managed funds to measure up to. In other words, the world can look different when measured by someone other than S&P.

My intent is not to be critical of S&P. Rather, it is to simply observe that the U.S. equity market is measured in a variety of ways and by a variety of firms. Those differences need to be acknowledged before we accept any one index or index provider as being the ultimate measurement of any market.

In short, the percentage of actively managed funds that outperformed the Morningstar U.S. Large Cap Growth Index over the past 19 years was considerably higher than the percentage of actively managed funds that beat the S&P 500 Growth Index.

Thus, your assessment of the ability of actively managed funds to beat their benchmark will depend entirely on which benchmark you select. The simple message is that S&P is not the only maker of benchmarks. And, as we have seen, there can be considerable performance differences among the various makers of indexes.

In summary, if the active-versus-passive debate is one that you no longer fuss with, you can simply focus on the clear value premium that exists in the small-cap U.S. equity space. When choosing a small-cap U.S. equity fund, look for one that has a value tilt.

The next time a growth-versus-value brawl breaks out, it's important to clarify which "benchmark" indexes are being used in the performance comparisons. As we have seen, it matters a lot.

And one other thing: You'll find that many small-cap value funds have already closed. The small-cap value premium is not a new finding.

When choosing a small-cap U.S. equity fund, look for one that has a value tilt.

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Craig L. Israelsen, Ph.D., a *Financial Planning* contributing writer in Springville, Utah, is an executive in residence in the personal financial planning program at the Woodbury School of Business at Utah Valley University. He is also the developer of the 7Twelve portfolio.

The Struggle to Be Simple

Three index funds may be all clients need, but that's rarely what they end up with. Here are 10 valid reasons we create more complicated portfolios.

BY ALLAN S. ROTH

IF DATA DICTATES THAT SIMPLE OUTSHINES complex, why then do we planners continue to design more complex portfolios?

As an example of simplicity, over a decade ago I taught my son how to invest using just three index funds:

- A total U.S. equity index fund such as Vanguard Total Stock Market Index Fund (VTSMX).
- A total international equity fund such as Vanguard Total International Stock Index Fund (VGTSX).
- A total bond fund such as Vanguard Total Bond Market Index Fund (VBTLX).

With these funds (or better yet, lower-cost share classes of these funds), my son owned a slice of virtually every publicly held company on the planet, as well as an approximation of nearly every fixed-rate investment grade bond in the U.S. What's more, Noble Laureate William Sharpe's research paper, "Arithmetic and Active Management," proved that owning the entire market at the lowest costs invariably beats the majority of investors.

Owning even one other stock fund will actually decrease diversification since it will be making specific bets on industries, styles or other factors. In fact, the portfolio can arguably be simpler with a two-fund portfolio where the U.S. and international stock funds are replaced by a total world stock fund such as VTWSX.

Over the years, I've benchmarked hundreds of portfolios against the equivalent weighted three-fund portfolio and can count on one hand the number of portfolios I've seen that bested this benchmark. Most fall short by far more than expenses can explain. Yet I can also count on both hands how many times I've personally designed such a portfolio for clients.

Admittedly, while these three funds are the core of my personal portfolio, it is still far more complex than I would care for. So why are the portfolios that my firm helps design still more complex than they need to be? Here are 10 reasons – some good and some bad.



1. TAX RAMIFICATIONS FROM LEGACY HOLDINGS

Theoretically, we could sell everything to build the three-fund portfolio. But the theory hits reality when the tax bill shows up. It is better to have more money than to be theoretically superior.

As an example, I bought my first index fund about 27 years ago. It was an S&P 500 fund. Clearly it's inferior in that it misses out on the small- and mid-cap stocks. But rather than pay the IRS sooner, a simple solution is to buy one of many extended market index funds.

This completion fund owns every stock in the U.S. that is not part of the S&P 500. Thus, a portfolio of roughly 80% S&P 500 fund and 20% extended market index fund builds a total stock index fund without paying the IRS. Rarely do I have a client come to me with portfolios that have no tax legacy. Decisions have to be made between the costs of building the better, lower cost and more diversified portfolio versus the benefits.

2. BOND ALTERNATIVES

I'm not arguing in favor of more expensive active bonds here. Though they may outperform bond index funds by

taking on more risk, our clients will regret it when markets tank like in 2008. I have most of my clients buy certain CDs. Why?

Because bond prices will decline if rates increase. Many CDs purchased directly from banks and credit unions offer low early withdrawal penalties.

This essentially gives clients a put to make the institution buy the CD back at a small discount. As an example, the Vanguard Total Bond fund would lose an estimated 9% if interest rates rose 2% in one year. By comparison, a five-year CD at Capital One would net a gain of 1.15% after paying the penalty in that same scenario.

Brokered CDs don't offer the same puts but offer higher rates than the total bond fund. There is less liquidity, however, due to costs of selling these CDs, since they are essentially bonds.

Low-cost TIPS funds also offer some protection against rising rates as their yield is positively correlated to inflation.

3. INTERNATIONAL BONDS

The three-fund portfolio leaves out the largest single investment class on the planet – international bonds. Vanguard makes a very good case that this asset class is a critical part of any diversified portfolio. For decades, I avoided international bonds due to high fees. But a few years ago, Vanguard launched a total international bond fund and includes this fund in its fund of funds, such as target-date funds.

Though a close call, I have chosen to avoid this asset class as it's still more expensive when you include the hedging costs, and the need for diversification in this asset class is less.

4. HAVE SOME FUN

It surprises many clients when I tell them it is OK to gamble a little and have a fun portfolio. I do the same in my own portfolio to accommodate that piece of my mind that wants to have the excitement that index funds don't provide.

I buy small positions in one or two stocks a year, always being sure to set strict limits.

I give my clients limits and rules for their fun portfolio as well, and caution them that their biggest danger is not that they could lose everything.

Rather, if they do well, they may think of themselves as the next Warren Buffett and bet the farm.

5. SMART BETA

Why would you want a cap-weighted index when smart beta and other factor investing strategies exist? Small, value, momentum-based strategies that add risk-free return, right? Wrong!

Even Eugene Fama and Ken French noted these factors weren't a free lunch, and Dimensional Fund Advisers (Fama is on DFA's board) acknowledges the same.

These factors give extra return as compensation for taking on more risk. After the higher fees and tax-inefficiencies, you are left with a lower risk adjusted return. So "dumb beta" may actually be smarter.

6. THE BELIEF WE KNOW THE FUTURE

Current opinion seems to be that interest rates are going to rise and bonds will decline, if not a total burst of the 35-year bond bubble. Why then should investors own an intermediate-term bond fund? Because economists have a track record of calling the direction of interest rates correctly far less than a 50/50 coin flip.

And advisers time stocks just as poorly.

It surprises many clients when I tell them it's OK to gamble a little and have a fun portfolio.



BLOOMBERG NEWS

Unfortunately, advisers and clients alike typically time markets badly.

We think we know what companies, sectors, or even countries will outperform.

Unfortunately, we time markets badly and construct complexity to try to achieve that outperformance.

7. ALTERNATIVE ASSETS

If we can own asset classes that zig when the market zags, we can create a higher risk-adjusted return. This is known as having asset classes with negative (or at least low) correlations to stocks.

We build in alternatives like managed futures, market neutral funds and even

advice to clients is, take the risk with stocks and have the fixed income act as ballast to their portfolio. That total bond fund earned more than 5% in 2008 when the average bond fund lost 8%, and many lost half their value or more.

9. CLIENT DESIRES

Many clients come to me saying they want me to tell them what they want, whether it's income, low taxes or a particular product. I review all of their requests but, in the vast majority of cases, I explain why I disagree and refuse to recommend.

Almost all of these desires are rooted in the belief that they are smarter than the market. In most cases, the client gets it. In some cases, the investor doesn't become a client. I consider both cases successful outcomes.

In most cases, the client gets it. In some cases, the investor doesn't become a client. I consider both cases successful outcomes.

10. FEE MODELS

In my view, the mother of all bad reasons to avoid simplicity is our fee model.

All fee models have conflicts of interests. If we built

a simple three-fund portfolio, how could we justify charging assets under management?

All we would be doing is some occasional rebalancing. Even robo advisers that charge ultralow fees use many funds.

While I'm an hourly adviser, that fee model doesn't eliminate conflicts, either. The simple three-fund portfolio with a target and tolerance range for each fund sends the client on their way without them needing me in the future.

As I said, I rarely design a three-fund portfolio. And the reasons I don't are almost always due to tax legacy, the use of CDs, TIPS, international bonds and carving out a fun portfolio. But I'll keep trying to simplify for my clients, since ultralow fees with the highest diversification is simply brilliant. **FP**



Tax legacy is a reason to not sell some assets when rebuilding a portfolio.

inverse funds. The problem is that these alternatives also have ultralow or negative expected returns, after fees.

As I tell clients, taking half of their portfolio to the Las Vegas tables has a zero correlation with stocks, but isn't a very smart move.

8. INCOME

I've seen more money lost in the name of income than any other reason.

Various advisers have told me that MLPs were merely toll-roads to pump oil and natural gas, and that the 5%-to-7% yields were risk-free. Rather than own a high-quality bond fund like a Barclays Aggregate index fund, advisers are again lowering credit quality, forgetting the lessons of 2008.

Total return is far more important! My

Allan S. Roth, a *Financial Planning* contributing writer, is founder of the planning firm Wealth Logic in Colorado Springs, Colorado. He also writes for *The Wall Street Journal* and *AARP the Magazine* and has taught investing at three universities. Follow him on Twitter at @Dull_Investing.

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FROM: GROWTH VS. VALUE DEBATE DERAILED

1. What was the 19-year average return of the Morningstar U.S. Large Growth Index from 1998 to 2016?

1. 5.76%
2. 3.88%
3. 6.37%
4. 4.45%

2. What was the average return of the S&P Midcap 400 Value Index during this same time period?

1. 9.16%
2. 8.56%
3. 10.21%
4. 7.52%

3. What was the average return of the Russell 2000 Growth index during this same period?

1. 5.97%
2. 9.39%
3. 8.8%
4. 5.58%

FROM: MASTERING ALT INVESTMENTS

4. Which section of the Internal Revenue Code specifies the types of precious metals that can be used in retirement accounts?

1. IRC 61
2. IRC 408 (m)
3. IRC 501(c) (3)
4. IRC 404(a)

FROM: MANAGING CLIENTS' CASH CRAVINGS

5. Which of these factors was shown to have the highest self-reported correlation with financial well-being for consumers, according to a 2016 study?

1. Average monthly income
2. Total value of investments
3. Average monthly liquid wealth
4. Level of indebtedness

FROM: SEEKING DIVIDEND GROWTH? THESE 'ARISTOCRAT' ETFs MAY FIT THE BILL (Online only)

6. For the 12 months ended in June, the net dividend increase for U.S. domestic common stocks slid by how much (in dollar terms) compared with the prior year?

1. 7.9%
2. 2.3%
3. 4.4%
4. 5.2%

7. During the same period, the number of reported dividend increases slid by what percentage?

1. 3.5%
2. 1.2%
3. 5.5%
4. 2.3%

FROM: WITH FEES FALLING, HOW CAN ETFs STAND OUT? (Online only)

8. How much was the average expense ratio of ETFs in 2016?

1. 0.30%
2. 0.34%
3. 0.23%
4. 0.27%

9. Since 2005, in which year were ETF expense ratios the highest?

1. 2008
2. 2009
3. 2014
4. 2012

FROM: CFP BOARD'S PROPOSED NEW STANDARDS RISK WHACK-A-MOLE APPROACH (Online only)

10. Which of these is NOT considered sales-related compensation, per the CFP Board's proposed new standards of conduct?

1. Spreads
2. 12(b)1 fees
3. Referral fees
4. Soft dollars

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Women, Money and Power

How one planner's pro bono work changed how she approached teaching her daughters about financial matters.

BY LINDSAY BOURKOFF



WHEN I AGREED TO SERVE AS A VOLUNTEER PLANNER for the Jewish Divorce Assistance Center of Los Angeles, I hoped to offer advice to women in crisis, enabling them to rebuild their financial lives. But the surprising result of this service was its powerful impact on my own family.

As I began to help the clients of JDAC, I quickly noticed a common thread: Even though many of these women hold advanced degrees in engineering or law, own businesses or possess unique skills, too many lacked a basic understanding of their family's finances. They had been kept in the financial dark during their marriages and consequently had taken no executive role in their family's financial life.

Some didn't know if they had retirement accounts, if their homes were owned in trusts or what level of income they needed to survive. This led them to feel helpless and lost. In one case, a husband informed my client – who had left the workforce to raise their children – that since she didn't have a job; she didn't get to know their income. These women were often understandably fearful to leave their marriages, worried that they'd be unable to independently manage their own finances.

It became clear to me, as never before, that knowledge about money was an essential power in relationships. As a mom of twin 9-year-old daughters, it got me thinking – was I guilty of keeping my own daughters in the dark about money? Was I doing enough to educate my girls financially?

AN EARLY START

Even as a young girl, I noticed how open my dad was with me about money. He would spend time teaching me about his passion – investing – and explained such concepts as

compound interest and diversification of risk. He discussed how important it is to plan for the future and how much he was setting aside to help pay for my college education.

Looking back on my own childhood, I now realize that my father's financial lessons around the house gave me confidence and allowed me to understand and embrace matters of money rather than fear them.

It was after volunteer sessions with several women that I began transmitting financial knowledge to my own daughters, as my dad had done with me.

At first, my mini lessons were casual and focused on broader principles. We spoke about making financial trade-offs, living below your means, and the difference between spending on consumption versus investing for the future.

EMPOWERING THROUGH OPENNESS

Now our talks have started getting a bit more complex with specific applications to our family's finances – how our mortgage works, why we own life insurance and how we save for retirement. My husband and I don't expect them to grasp everything overnight, but I believe that my willingness to be open about money will demystify the subject, inspire their own learning and ultimately empower them.

Because so many of the women I counseled lacked confidence around money, I was inspired to offer an early boost to my daughters by being open and honest about our finances. Indeed, what started as a decision to try to help the women of my community has led me to take initiative with my own young women and help raise them to be in a position of power to succeed in their relationships, their careers and their lives.

FP

Lindsay Bourkoff, CFP, is the director of financial planning at Shrier Wealth Management in Los Angeles. Follow her on Twitter at @lindsaybourkoff.

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