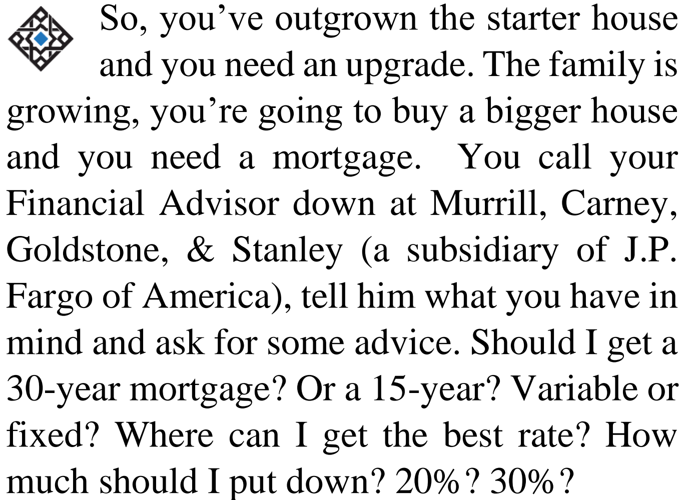
The Importance of One Letter



So, you've outgrown the starter house and you need an upgrade. The family is growing, you're going to buy a bigger house and you need a mortgage. You call your Financial Advisor down at Murrill, Carney, Goldstone, & Stanley (a subsidiary of J.P. Fargo of America), tell him what you have in mind and ask for some advice. Should I get a 30-year mortgage? Or a 15-year? Variable or fixed? Where can I get the best rate? How much should I put down? 20%? 30%?

Well, that's just great says your advisor. Let's talk about that last part first. Are you going to be making a withdrawal from your brokerage account for this down payment? Well, yes, you say. I'm going to need at least $100,000, maybe more. I've got good news your advisor says. You don't have to withdraw anything from your portfolio, you can keep that money invested. We can get you the money you need with a portfolio loan. And the really good news? The rate will be lower than a standard mortgage, there's no preset repayment schedule and we can get this approved immediately. No appraisal required. Should I send you the paperwork?

It seems so easy and it is. No submitting tax returns or W-2s because the only thing that matters is the value of your securities portfolio. But is it the right thing to do? Is your advisor recommending this because it is in your best interest? Or his? The answer can be found in one little letter.

Is your Advisor an ***Adviser***? Merriam Webster provides the exact same definition for each spelling as "one who gives advice" but in the investment world there is a vast difference between the two.

"**Investment Adviser**" is a very specific legal term found in the **Investment Advisers Act of 1940**. These persons are held to a ***fiduciary standard*** – they must act in the best interests of their clients.

Specifically excluded from the definition are broker-dealers – stock brokers. Stock brokers use a lower standard of conduct, the so-called ***suitability standard***. It does ***not*** require that they act in your best interest.

The Investment Advisers Act of 1940 uses the "e" spelling and that provided a loophole for Wall Street to exploit. They couldn't call their salespeople "advis*e*rs" because the SEC had a very specific definition for that term. "Advis*or*" on the other hand, had the same popular definition but no restriction on its use by the SEC. Thus, was born the "Financial Advisor" title and a lot of confusion.

"Financial Advisors" who work for brokerage firms are not fiduciaries. The fiduciary duty of an ***Investment Adviser, like Alhambra*** is, according to the SEC, a "duty of care and a duty of loyalty, is principles

based and applies to the entire relationship between the adviser and the client". Brokerage firm representatives do not meet this requirement.

Investors continue to be confused by these titles which is exactly what the brokerage industry wanted when they started using them. 55% of those surveyed believe that "financial advisor" and "broker" both act as fiduciaries. Less than half believe the same about "investment adviser" or "investment adviser representative". And 62% believe that "financial advisors" are paid to provide investment advice when their real function is to sell you investment products.

Let's go back to the scenario we opened this with. Did your "financial advisor" give you good advice? Portfolio loans have become very popular in the brokerage industry – outstanding balances are over $50 billion now – and it isn't because the public was clamoring for a way to leverage their investment portfolio. "Financial advisors" have pushed these products for one reason – more money in the advisor's pocket.

Portfolio loans are nothing more than disguised margin loans. A margin loan is initially limited to 50% of the value of the marginable securities. That percentage can drop to as low as 30% before you have to put up more money or securities – or your broker starts liquidating your account.

But a portfolio loan, because it is originated on the bank side, is not subject to the same rules. Most banks will allow loans where your portfolio only represents 30% of the total loan. $1,000,000 loan requires a $300,000 portfolio. But banks aren't stupid so if the value of your portfolio drops, you'll have to come up with more money to bring the value back up to 30% of the outstanding balance.

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