A Conflict of Interest to Bank On

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The big banks are up in arms about another duty being added to their job deion…that of tax collector.

On the ladder of loathing, banks are only a rung higher than politicians.

The government’s $6 billion hit to banks is simply playing to the crowd.

The reality is that the banks won’t be paying the tax. The bean counters have already worked out which deposit rates are to be trimm
which fees are to be increased, and what loans are going to be taken up a few basis points.

I’m not so sure there’ll be too much trimming of dividends. After all, investors chasing yields keep share prices up. And there’s nothin
healthy share price to trigger a banker’s bonus.

Rest assured, self-interest means any contribution to the government’s tax take from dividends will be modest.

Last week was one the bankers would rather not have had. In addition to their new tax-collecting duties, the government announced
a Productivity Commission review into competition in the financial system.

Westpac’s chief teller, Brian Hartzer, was far from happy over the prospect of its wealth management division being hived off from th

The Australian reported him as saying ‘…*we think the banks are well placed to provide this* [financial advice and insurance] *in a sus
way, free of conflict and abuse and our customers can get a lot of benefit from it.*;

The report made no mention of whether, when making this statement, Mr Hartzer’s tongue was in his cheek or not.

In simple terms, the bank’s financial advice business model is: The bank-owned or aligned planner recommends a bank-owned proc

Just exactly how many tax dollars are being spent to determine whether there’s a conflict of interest?

In my book, *How Much Bull Can Investors Bear?*, I wrote with the express purpose of making people think a little more deeply about
investment options. A guide to sorting out the wheat from the investment industry’s chaff.

A chapter was dedicated to the inherent conflict that arises from the institutional ownership and/or alignment of planners.

On balance, the book has been well received. However, it did hit a raw nerve with a financial planner.

Here’s an edited version of this planner’s email:

‘*I downloaded your new book %26 took a look at the index and saw your* [sic] *had a titled “real life experiences with financial pla*

‘*To be honest for a former financial planner yourself — I think your* [sic] *a sellout %26 you only put down other advisors to bring people to your “I am a former advisor sharing you the truth newsletter”, there’s a lot of money being missed by your “clients” sitti cash over the last few years.*

‘*I take great pride in what I do %26 I do my best to always leave my clients in a better financial position. I work with a small firm all carry knowledge in various areas which help in benefiting our clients.*

‘*Everyone always brings down the financial planning industry and snake oil salesmen. Yes we have targets, yes I earn a wage % I studied hard in my own time out of my own pocket to better understand the financial markets and world.*

‘*Yes, we are* [on] *course to have a crash much like 1929, but, what happens if we get nothing for another 10 years.*

‘*The only reason you think what you are doing is right, is because PPP is paying you a commission to do so. After all, you have newsletter to sell.*’

The planner’s full email was shared with readers of *The Gowdie Letter* in January this year.

This is the edited version of my reply (also published in the January 2017 edition of *The Gowdie Letter)*

‘*Firstly, I acknowledge the financial planning industry has far more well-meaning and dedicated advisers than it does “snake-oil” salesmen.*

‘*Secondly, readers were asked to submit their “real life experiences — good or bad — with financial planners”. Unfortunately, no the many responses I received was about “good experiences”. Perhaps that’s a reflection of the reader profile we attract at Port Publishing and/or an example of bad news spreading faster than good news. Whatever the reason, the responses in the chapte indicative of what was received.*

‘*Thirdly, highlighting the inherent flaws in the industry business model hardly qualifies as a “sell-out”. The industry has significan conflicts of interest, within which well-intentioned and well-educated advisers have to operate.*

‘*Until those conflicts of interest are removed, then it’s a case of “caveat emptor”. The purpose of the book was to “let the buyer b*

‘*More than 80% of financial planners are directly or indirectly associated with Australia’s six largest financial institutions. This is j wrong. Can you imagine the outcry if 80% of medical professionals were employed by, or aligned with, the major pharmaceutica companies?*

‘*Commissions or percentage-based remuneration has supposedly been replaced by fees. Yeah right. I bet if I went into most fina planning practices, and looked at the fees charged to a client with $500,000 compared to one with $5 million, the fees would be the latter…even though the same amount of work could have been done for both clients.*

‘*From my conversations with industry participants, very few practices actually charge fees on a per-hour basis. Fees still tend to based on the amount invested.*

‘*Undertaking continuing education should be congratulated. However, these are my concerns: What if the content you are being is no longer applicable? What if the global economy is caught in the grip of private sector debt deflation and, instead of asset pri appreciation, there’s asset price depreciation…similar to the Japanese share market from 1990 to 2009? What if the Fed has ru stimulus “ammo” and markets flounder for years?*

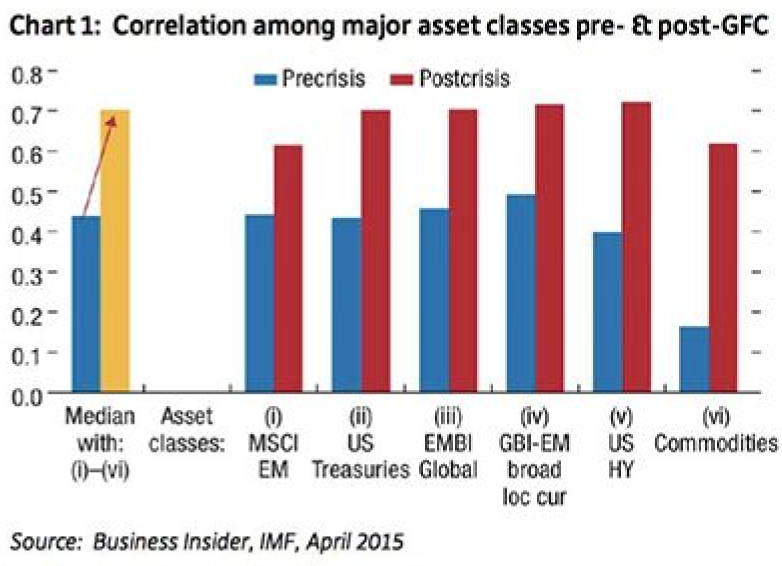
‘*My guess is the industry still emphasises the risk minimisation benefits of diversification…the old “Don’t put all your eggs in one approach.*

‘*99 out of 100 people will nod and say, “That’s true.*”

‘*But is it?*

'*Here is an excerpt from the January 2017 issue of* The Absolute Return Letter*, written by Absolute Return Partners Chief Investment Officer Niels Jensen (emphasis is mine):*

> '…Long term readers of the *Absolute Return Letter* will know that I have always been of the opinion that we have never properly exited the global financial crisis (the "GFC") of 2007–08. One of the conditions I have used to make my point is the high correlati between risk assets, and how life as an investment manager has become complicated as a result of that.
>
> 'Prior to the GFC, you could fairly safely assume that diversification across a number of risk assets would dramatically reduce th overall volatility risk, but not anymore. The GFC changed how risk assets correlate with each other (Chart 1), and **when the correlation between risk assets approaches one, diversification does little to reduce the overall volatility risk**.'



Source: Absolute Return Partners
[Click to enlarge]

'*Central banks flooding the world with money since 2008 have lifted all assets…with the exception of cash.*

'*Therefore, assets valuations are tied more closely to each other. One falls and the others are much more likely to follow. This is not meant to happen with genuine diversification.*

'*Central banks have temporarily "solved" a debt crisis with more debt, and, in doing so, have made the world a far more dangerous place to invest.*

'*In his book,* Different Seasons*, Stephen King wrote, "There's no harm in hoping for the best as long as you're prepared for the worst.*"

'*In my experience, the investment industry rarely prepares clients for the worst.*

'*The concerns I raise are not even considered to be a remote possibility by the industry, despite the following factors:*

1. *Global debt levels exceed all previous pre-credit crises highs.*
2. *Global interest rates are at historic lows.*
3. *The US share market is, by a number of historical valuation measures, extremely overvalued.*

'*Historic extremes — at the high-risk end of the curve — are not the conditions your average mum-and-dad clients should be exposed to…but they are.*

'*In an interview with Yahoo Finance in August 2016, Nassim Taleb — author of* The Black Swan and Antifragile *— was asked: What are the biggest risks out there right now?*

'His reply (emphasis is mine):

> ‘The fact that the world, as a result of quantitative easing, has seen an asset inflation that benefited the uber-rich, and that nothing has been cured. One cannot cure debt with debt, by transferring from private to public sectors. The markets will ultimately crash again, **although this time it will hurt a lot more people.**’

‘*Mark Twain said, “The man who is a pessimist before 48 knows too much; if he is an optimist after it, he knows too little.”*

‘*My cautious pessimism is borne from over 30 years in the investment industry, and being charged with the responsibility of managing my family’s wealth.*

‘*I really do not care whether I could’ve made 9% from the market last year or the year before that. What I do care about is not exposing our capital to a level of destruction that makes recovery an almost impossible task.*

‘*Remember, losing 50% requires a 100% gain to break even. Lose 60%, 70% or, heaven forbid, 80%, and the climb to recovery — just back to your starting capital — becomes that much steeper with every 10% loss.*

‘*If that means foregoing 5%, 6% or 7% in returns in the interim, that’s a price I’m prepared to pay. The financial planning industry does not have the luxury of taking that conservative, capital-preservation approach. Clients will not pay fees to wait in cash…even if hindsight reveals it was the best place to shelter from the storm.*

‘…*I understand your concern and frustration. However, taking aim at the messenger does not change the message.*

‘*Never before in our investment lifetimes have we faced more dangerous market conditions.*

‘*You even acknowledge that “we are* [on] *course to have a crash much like 1929.”*

‘*Perhaps it might be 10 years away. But that, too, would make this market one for the history books.*

‘*In duration, this is the second longest bull run in 60 years.*

‘*Extending this bullish period out another 10 years is a very, very low probability.*

‘*Successful, long-term investing — as opposed to making above-average, short-term gains — is a percentages game.*

‘*In both duration and valuation, the current US bull market is extended. Does that mean it cannot go on for longer or go higher? Absolutely not.*

‘*In fact, I fully expect, and have planned for, the US market (Dow Jones) to breach the 20,000-point level and enjoy a period of euphoric buying.*

‘*The upbeat mood will take the All Ords with it.*

‘*We’ve seen similar moves before on the S%26P 500 index:*

Source: Macro Trends
[Click to enlarge]

‘*They did not end well.*

‘*In my opinion, this market does not have another 10 years of positivity left in it.*

‘*What is the potential loss if the market overshoots the mean and dips heavily into undervalued territory?*

‘*70% or even 80%.*

‘*Personally, that is not a risk I’m prepared to take with my capital.*

‘*Imagine if clients of financial planners were asked: The potential cost for receiving an extra 5% or 6% per annum for the next one or two years comes with the possibility of losing 50–80% of your capital. Do you still want to invest?*

‘*The answer would be a resounding ‘No.’*

‘*But I doubt this discussion is taking place.*

‘*Finally, there’s one more point I’d like to address from* [the email]*:*

> ‘The only reason you think what you are doing is right is because PPP is paying you a commission to do so. After all, you have a newsletter to sell.’

‘*Yes, I have a commercial arrangement with Port Phillip Publishing to provide my views on a weekly basis. However, to state this is “The only reason you think what you are doing is right” could not be further from the truth.*

‘*Each week, I share with subscribers some of the information that’s influencing my thinking on how best to invest our family portfolio on a considered risk versus reward basis.*

‘*Suggesting people remain patient, by staying in cash and dollar-cost averaging into the British pound, is hardly riveting stuff aimed at sending circulation numbers skyward.*

‘*…I do what I think is right (and only with hindsight will we know whether it’s actually right or not) because it’s what I genuinely believe in. End of story.*

‘*The other main difference between myself and a good percentage of financial planners is I actually ‘walk the talk’. There are plenty of planners who advise on a theoretical, textbook basis…but don’t have any real skin in the game.*’

The financial planning business model is rife with conflict.

The name of the game is *funds* management. The more funds funnelled into products owned by an institution, the higher the earnings. You then apply a multiple (PE ratio) of 16 to those earnings and you have a multi-billion-dollar business.

What's the best way to guarantee funds flow into your products? Own the adviser network making the product recommendations.

It really is that simple.

In the interest of saving tax dollars, if the Productivity Commission wants a copy of my book, please contact Port Phillip Publishing…we'll email it to you for free.

It'll tell you all you need to know about why investors will be far better served if the conflict you can bank on is removed.

On a practical level, this is unlikely to happen, so it's a case of 'caveat emptor'.

Regards,

Vern Gowdie,
For *Markets %26 Money*

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Vern Gowdie
Vern Gowdie has been involved in **financial planning** in Australia since 1986. In 1999, *Personal Investor* magazine ranked Vern a
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