HAAS Fydroski Financial Services, Inc.

Investments - Planning - Education

# IPE Insights

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## Look Back 1st Quarter

*Anyone who believes that exponential growth can go on forever in a finite world is either a madman or an economist* – Kenneth Boulding (Economist, activist, poet, scientist, philosopher, cofounder General Systems Theory, 1910-1993)

After one of the worst starts in U.S. stock market history, the Dow Jones Industrial Average and the S&P500 settled down to end the first quarter 2016 with slight gains; alternatively, the NASDAQ also gained back a lot of lost ground but ultimately ended the quarter with a minor loss. It was a wild ride and a tale of two halves. U.S. equity markets began the year by falling 6% the first week in January and continued back peddling into February. By the middle of February, the S&P500 was down 10%. However, in a 180 degree turn, the S&P500 started a mid-month reversal and by the end of March recouped its entire decline to finish the quarter with a 1.3% gain

The freefall in equities seemed to end when the Federal Reserve began backing away from its plan to impose four interest rate hikes in 2016. When the magic number went from four hikes to two, enough traction was provided to get the markets back on track. It is difficult to make sense of markets that plunge and rebound as quickly and abruptly as we have seen in the first quarter of 2016, but the story pales in comparison to the commodities market. In the commodities arena, the path of crude oil in the first quarter resembled a W. The price of oil initially dropped 22%, then experienced a 19% rebound, followed by another downturn of 16% and finally ended with a 35% rally. Such wild mood swings may reflect the economic uncertainty of today's world.

My personal view is that we are now paying the price for all the stimulus money that was forcefully thrust into our economy by the Federal Reserve. The stimulus money flowed freely for several years but there was never a real plan on how to end the process. In the United States, we are facing withdrawal pains now and it seems a bit scary to me. Europe, China, Japan and a few other countries are still providing stimulus to their economies. In spite of all the stimulus both here and abroad, the world economic engines are still not running smoothly. In my opinion, the day of reckoning is yet to come.

The final tally of the first quarter 2016 saw the DOW up 2.2%; this topped the major averages. The S&P500 came in second with a gain of 1.3% and the tech heavy NASDAQ was down -2.7%. In what many analysts consider to be the strongest stock market months of the year, the broad market Dow Jones Total Stock Market Index was up a meager 0.9% for the quarter (Source: Wall Street Journal (4-1 & 4-4 -2016). Not a very impressive showing for putting your best foot forward.

On the mutual fund side of investing, the Average U.S. Stock Mutual Fund was down -0.4% in the first three months of 2016. Large Cap Growth (-2.8%), Small Cap Growth (-4.8%) and Multicap Growth (-2.9) all helped pull the average into negative territory. The category leader across the board was Gold Oriented Funds with an eye opening +42.2% first quarter return. However, we should not forget that even with this spectacular return in the first quarter, Gold Oriented Funds averaged losses of -18.5% over the last five years. After many years of leadership, the Health/Biotechnology sector was the biggest loser in quarter one with a painful average loss of -14.0%. It should be noted that no investment maintains market leadership forever. It may be days, weeks, months or even years but every investment hits a peak and then declines. The challenge is to recognize when a downward pattern becomes a true direction change and that is not always an easy task.

In the fixed income realm, the most productive Taxable Bond Fund was the Long Term U.S. category with a +3.5% return; however, the Average Taxable Bond Funds was up only +1.7% for the first quarter 2016 (Source: Wall Street Journal 4-4-2016). Comparatively speaking, on a risk adjusted basis, bonds preformed much better than their stock counterparts. As I write this article, the end of first quarter strength has carried over into the second quarter but cracks in the armor have recently begun to appear. Is the "sell in May and go away" mantra about to emerge? Based upon my market research, I think that there is a strong probability and possibility that market weakness will return. Current market data indicate that this is still a bull market; however, strong bullish sentiment readings are usually a harbinger indicating that the market rubber band cannot get stretched much farther. Only the market will give us the real answer and the indication of that direction should come soon.

Spring is in the air, my John Deere tractor is ready to go and it is tree planting time for me on the weekends. Nature's greenery (including dandelions and weeds) are starting to emerge from their winter dormancy. It is a great time to be outside after a winter that always seems to last too long. As an FYI, I will be attending an out of state money management conference the first week in May.

Finally, the question comes up from time to time, "What is a Registered Investment Advisor? Please read the article on the second page. Haas Financial Services Inc. is a Registered Investment Advisor with the State of Michigan and I am an Investment Advisor Representative of Haas Financial. I also have the professional designation of Certified Financial Planner Practitioner. Take good care and think spring!!!

# What exactly is an RIA?

*By: Brooke Southall*

The term "RIA" is thrown around with abandon in the financial services industry but if you ask people what it means, you are likely to get a confusing array of answers.

The confusion about defining and describing an RIA lies not only in what is being described but in the fact that it can stand for different depths of explanation depending on its context and who is using it. So it's a case where the reader can be confused equally by the definer who wants to be thorough and the one who wants to keep it down to its barest meaning.

**Layers**

In this attempt at definition, we will try to let it unfold in layers and the reader can stop when they have heard all they want to hear or plow on and understand "RIA" in all its nuance.

In simple terms, an RIA is a registered investment adviser. This generally means a financial firm that engages in advising others about investing in securities, gets paid for it and is subject to oversight by the Securities and Exchange Commission or their equivalent regulator at the state level.

Under this structure , these companies are paid a fee similar to the way a mutual fund charges clients. For instance, a typical arrangement might call for an advisor to charge an annual fee of 1 % of assets under management. On a $1 million account, a client would be charged $10,000. RIAs, however, can also charge fixed or hourly fees though these methods are employed with less frequency.

A confusing factor is that people often believe that the term "RIA" applies to an individual that works for the advisory firm. However, this is inaccurate. Individuals who provide advice on behalf of the firm are referred to as investment adviser representatives. It's the firm itself that is called an RIA.

**Hoops**

To become an RIA or IAR, there are some hoops to jump through. Both the firm itself and the individual IARs generally have to submit separate applications to become licensed to do business. The RIA has to submit its application using the Form ADV, whereas each IAR has to submit their application using the Form U4.

Moreover, most states require each individual IAR to be qualified before they will approve their applications. While there are nuances depending on the particular state in which an IAR application is filed, most states will consider an IAR qualified if they either: 1. have a specific professional designation likes a CFP or CFA; 2. have passed the Series 65 exam; or 3. passed both the Series 7 and Series 66 exams combined.

All RIAs fall under either federal or state jurisdiction. Traditionally RIAs with less than $25 million of assets under management will register with state regulators, but soon that amount will be raised to $100 million of AUM. Even if an RIA has less than $100 million in AUIVI, it may opt for SEC Registration if it is required to be registered with fifteen or more states.

Another level of confusion is that the term "RIA" applies to both large institutions like American Funds that have hundreds of billions of AUM and the financial planner who advises clients about their investments but does not manage their portfolios. "RIA" in this context may also encompass Advisers to mutual funds and hedge funds as well as pension consultants who also may need to register.

**29,000 RIAs, not really**

There are about 29,000 RIAs in the technical sense -both registered with the SEC and with the states, according to RIA Database of Charlotte, N.C. When we use the term RIA at RIA Biz, we are primarily referring to about 13,000 financial advisory firms that are either registered with the Securities and Exchange Commission or their equivalent state regulator and perform wealth management-related duties primarily for affluent individual investors. In this view, we are again following the lead of RIA Database that breaks out RIAs accordingly.

There are about 16,000 other RIAs that we are referring to more obliquely because they are broker-dealers, mutual funds, hedge funds, separate account managers or other financial firms obligated to have this structure in order to operate as businesses. Right now anyone with $25 million of AUM answers to the SEC. Soon it will only be advisors with $100 million or more as the states take greater control over RIAs. Approximately 4,100 RIAs will switch from SEC to state registration once the new rules take effect, according to what Carlo di Florio, director of SEC compliance said at the IA Watch best practices seminar on March 21.

For the most part RIAs work directly with individual investors in providing them advice related to their investments. But most advisors that work for these firms today have assumed a broader role in counseling clients more broadly on all issues relating to their personal finances. This can range from buying a house or car to overseeing accounting and estate matters.

**Elevator pitch**

Still, what nobody has yet developed to our knowledge is an "elevator pitch" description of an RIA -one that captures its effectiveness as a business model and how it is generally a better firm structure for delivering good and ethical financial advice.

When people ask me, here's what I say:

People starting an RIA are basically entering into a compact with the SEC whereby they agree to hold themselves accountable for the advice they give to clients. In exchange, the SEC permits these advisors to do two things that are essential for carrying out the successful rendering of advice: charging fees for that advice and making decisions on a discretionary basis so they can act efficiently.

*(Editor's Note: This article was written in October 2011 and presents a short and comprehensive description of what may be covered under the RIA umbrella. The amount for SEC registration is now $100 million)*