The David Miner

Communiqué

Summer 2016

"Simplicity is the ultimate sophistication."

Leonardo da Vinci

It's a Girl!

July 20th marked the arrival of a beautiful new granddaughter, Nalina! Amelia and Kiran are very happy and quickly getting used to parenthood. Amelia will be taking some maternity leave time away from the office, at least until the end of the summer. The new grandparents are very proud to welcome Nalina into the family!

New Mom Amelia and baby Nalina.
[Photo Credit: Kiera Thompson.]

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Market Commentary

Despite volatility, the U.S. stock market continues to test new highs. The Canadian stock market continues to be sensitive to oil prices. In the bond market, 20 percent of the world's $30 trillion in sovereign debt is trading at *negative* yields. As always, we stay diversified!

"If you think it is too expensive to hire a professional to do a job, wait until you hire an amateur." – Red Adair

Changing Regulatory Landscape
And what changing regulation means to you!

The investment experience for the consumer is changing, in many ways for the better. The year 2008 was a pivotal time as the financial sector experienced its roughest turmoil since the 1930's. Post 2008, most countries in the world, including Canada, reviewed financial regulation and started making change in the hope of providing better consumer protection. The good news, of course, is that despite a rough year in 2008, the financial sector did not fall apart. Close to my own heart, many of the world's stock markets have more than doubled since the market lows of March 2009.

Proud Papa Kiran with beautiful baby Nalina.
[Photo Credit: Kiera Thompson.]

What Happened in 2008?

Of course, the root of the 2008 financial sector problems was sub-prime mortgage lending by the U.S. banking sector. The problems were exacerbated by securitization and leveraging of those bad mortgage securities by investment bankers, effectively spreading the problem around the world like a virus.

Sub-prime lending was based on predatory pricing. Mortgages were provided to low income families in the United States, sometimes for the full purchase price of a house. Mortgage payments started low, but increased over two to three years. Eventually, those families were in over their heads and simply could not keep up with mortgage payments (therefore, they were called "sub-prime" mortgages). Sub-prime mortgage defaults sky rocketed. In the U.S. and many parts of the world, housing prices dropped. The stock market corrected, too.

Sub-prime mortgage lending with predatory pricing had a predictable outcome; yet, many financial institutions preferred their "ignorant bliss" (read "short-term profit") over the predictable mess that would result. As we know, the U.S. financial sector got bailed out with U.S. tax payer money. We also know that executive bonuses at U.S. financial institutions in 2009 hit record levels.

And so...more regulation everywhere.

Thankfully, stronger financial sector regulation was introduced in the U.S. ("Dodd–Frank Wall Street Reform and Consumer Protection Act") in July of 2010. In hindsight, the debacle of 2008 may have been avoided had the U.S. "Glass–Steagall Act" introduced in 1933 remained in force. After the stock market sell-off in 1929 and the depression in the early 1930's, Glass-Steagall was introduced to keep commercial banks out of risky businesses, particularly with depositor money, by maintaining a separation between commercial banking and investment banking. With the Financial Services Modernization Act of 1999, Glass Steagall was repealed as no longer necessary. (YES IT WAS NECESSARY!)

David and Dorinda train at Sunnyside for the annual dragon boat races at Toronto Islands.

Harder financial regulation after the 2008 sub-prime debacle was directed not only at U.S. banks but at financial institutions around the world. And there have been repercussions. For example, the number of financial advisors in the United Kingdom has fallen by 25% (Price Waterhouse Cooper, 2014 study).

So what does this mean to me?

In Canada, the number of dealers like FundEX regulated under the Mutual Fund Dealers Association ("MFDA") has dropped by more than 50% over the last twelve years. The growing costs of compliance management and the software systems to support compliance are too expensive for many small and mid-size dealers to operate profitably. Very simply, a number of smaller MFDA firms have merged into larger firms. That trend will probably continue. It is also a fact that there is a growing trend among dealers to increase their fees to advisors in order to cover their increasing costs.

FundEX and its parent company Industrial Alliance are large and have the critical mass to deal with the changes that are affecting the business. It is mainly because of those FundEX qualities that I moved my practice to FundEX three years ago. The FundEX business model is based on working with reputable advisors with established practices. FundEX is a firm known to "rationalize" (read "terminate contracts") of advisors deemed to be too much of a compliance risk.

David and Dorinda take in a Nationals Game during a recent visit to Washington D.C.

One of the most frequent questions I hear, particularly from new clients, is "How do you get paid?" For several years, our remuneration has been very simple. I have utilized funds with management fees and taxes that are embedded in the daily pricing of the funds. The proportionate amount of all the fund company fees and taxes (such as HST) is called the Management Expense Ratio ("MER"). The MER is a number that I often bring to the attention of clients. All else being equal, the lower the MER the higher the net investment returns to the client over time.

From the MER, the mutual fund companies pay for portfolio management, regulatory, accounting, legal, operations, marketing, reporting and other overhead costs. Also from the MER, fund companies pay dealers like FundEX a monthly "trailing commission" for service and distribution. That trailing commission is then divided between the dealer and the advisor. The amount of a trailing commission on any fund is publicly available through Fund Facts, prospectuses, and many other sources. Of course, please feel free to contact us directly if you have any questions. (Note - some advisors work differently by charging commissions on transactions or charging a periodic service fee directly to clients. We shall be discussing this topic more in future Communiqués.)

Why is this important?

Reporting is becoming more comprehensive. In early 2017, clients will notice performance reporting on 2016 year-end statements as well has the gross amount paid to FundEX by fund companies. I like transparency, and welcome better reporting. Even better, I would prefer that all of the fees and taxes being charged to clients be reported, not just what is received by FundEX. Hopefully we shall see that happen someday, too!