Registered Investment Advisor Firm

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Pulse Check

Last month the bull market in stocks celebrated its five year anniversary since the March 9, 2009 low. Have you participated and benefited from the five-year bull market in stocks? Many people say they haven't and those are typically the individual retail do-it-yourself investors that became frightened, left the market at the lows and haven't found the courage to re-enter.

According to a Bloomberg poll taken the first week of March, 77% of the respondents said the bull market in stocks since March 2009 has had a negligible effect on their wealth. Only 21% said the market's gains have made them feel more financially secure.

Overall, participants to the survey were "bearish." They felt the rally in stocks had passed them by. Further, only 30% of those surveyed expected the economy to improve over the next 12 months.

You may have heard the phrase "bull markets climb a wall of worry." Well if the Bloomberg survey is any indicator, it certainly suggests individual investors are worried.

Let's take a corresponding look at some of the metrics in play. According to the Federal Reserve, the poorest 75% of Americans generate only 0.5% of their income through capital gains, interest, and dividends.

Meanwhile the wealthiest 10% of Americans generate 11% of their income that way. However, most investors are not rushing back into stocks yet, despite the market hitting new highs, there's still a lot of fear out there.

Some investors may be worried about the prospect of rising interest rates. But history tells a different story.

For example, the Fed raised interest rates from 1999 to 2000. Instead of falling, stocks rose 10% during that time. Stocks did fall not too long after the Fed stopped raising rates.

Again the Fed raised interest rates from 2004 to 2006. Instead of falling, stocks rose 18% during that time. As before stocks again fell not too long after the Fed stopped raising rates.

Those are just the latest two examples, but the narrative is similar over the last 30 years. Stocks have regularly managed to go up during periods of rising interest rates.

Suitability

With this being the time of the year that taxes are due and generally your returns generally filed, many of you that use the services of a tax professional may have had or are having conversations surrounding your investment portfolios.

For those of you that rely on the advice of a financial services professional, the topic of investment suitability is something you should be aware of because the implications can be huge to your investment success.

DIG is a Registered Investment Advisor (RIA), and the RIA representative adviser has a fiduciary (legal) duty to act in the best interest of you, the client.

This differs from a registered representative of a broker/dealer who has a duty to his or her firm to recommend "suitable" products for their client. The suitability of an investment is truly at the core of the investment process. The concept is fundamental to the selection of products and is governed by legal principles.

So what exactly is a suitable investment?

The concept means that an investment must be appropriate not only in terms of an investor's willingness, but also in their ability (personal circumstances) to take on a certain level of risk. It is essential that both these criteria be met. It is not enough to state that an "investor is risk adverse." The investor must also be in a financial position to take certain calculated chances. Inherent in this process is the ability of the client to understand the nature of the risks and the possible consequences.

Frequently when discussing risk, people tend to only think in terms of "high" or "volatile market" risk which may be a natural extension of some equity market products and past performance. This is only one area of consideration of risk that must be examined when considering suitability.

Equally, very low levels of investment risk may excessively damage a portfolio and keep the portfolio from achieving its intended goal and a "broker" must have a reasonable basis for believing a recommended investment meets the client's investment objectives or goals.

As a practical matter, suitability is not always entirely clear cut. One can see that if a 25 year old risk-tolerant investor were to have 100% of their total assets in the stock market and that allocation drops to 60% or lower, the issue becomes much less clear considering their time horizon. However, if that same investor also owns some real estate and has a conservative tax-qualified plan, the 60% figure takes on a different perspective compared to someone with no other assets. Considering age and other aspects of the client's personal and financial situation is crucial in developing a suitable portfolio.

For example, it would be highly inappropriate for someone approaching or in retirement to have all their investments in futures contracts. Equally, it would be difficult to justify a 90 year old under some level of assisted living being sold a variable or indexed-annuity with a 7-10 year surrender period, yet sadly these practices do occur.

Suitability largely boils to down to asset allocation and both the law and good business practice prohibits placing the investor into an allocation that doesn't make sense to that particular person at that particular time with their goals and risk tolerances in mind. In other words, the portfolio must be appropriately designed and diversified to produce both reasonable rates of return at sensible and acceptable levels of risk.

So while suitability means one thing to a broker/dealer, it means quite another to a RIA registered representative who must determine that not only at the time the investment was acquired it was suitable for the client, but that it remains suitable for as long as that client relationship exists. The broker/dealer only needs to meet that threshold at the time of sale.

Davis Investment Group

Davis Investment Group is a fee-based Registered Investment Advisor firm servicing the needs of clients across the United States. Davis Investment Group custodies all client assets at Charles Schwab & Co. Davis Investment Group's home office is located at 714 Marin Street, Suite #C, Vallejo, CA 94590. The telephone number is (707) 648-2024.

If have questions or would like further information on this month's topics, please contact me directly at (925) 360-6819 or through email at: Bud@DavisInvestmentGroup.biz