MAIN POINTS:

- The investment industry continues to grow more complex and confusing each year. Investors must choose wisely who will manage their wealth.
- A fiduciary is someone who is bound to put your investment interests first. A fiduciary acts as if the money he manages were his own, and his actions are only an extension of the client interests.
- Firms vary greatly in the extent to which they adhere to fiduciary practices. Brokerages are among the least bound by a fiduciary standard, while independent trust banks have the highest fiduciary practices.
- A fiduciary will add value through several wealth maximizing activities: asset allocation, investment selection, expense and costs management, asset location, behavioral coaching and spending strategy.
- Investors that try to go it alone greatly underperform the markets. The opportunity costs far exceed the cost of hiring an investment advisor.
- Choosing a fiduciary as your investment advisor is one of the most important financial decisions you can make. It requires inquiry beyond obvious questions and focusing instead on how the advisor will meet the highest standard of care of your wealth.

Who Will Steward My Wealth?

The diversity of the investment industry today is astounding, and the industry becomes more complex every year. New products, strategies and services are created – many of them opaque and esoteric. New regulations are imposed or old ones revised. Business practices adapt to squeeze further value from clients. Wealth management today is like a jungle – a vast ecosystem with much abundance, but also many predators. The private investor must choose wisely how his or her wealth will thrive and survive.

Choosing an advisor can seem overwhelming. Most investors understandably ask questions that are relatively easy to answer – about investment performance, fees, assets under management, pedigree – rather than nuanced inquiries about meeting client goals and aligning with client interests. The investment industry is armed with ready-made answers to the obvious questions. The result is that many investors end up hiring an advisor who is reputable but disconnected from their clients' true interests.

> *How does the private investor ensure that the advisor is acting in his or her interests? We believe that investment success for the private investor requires hiring an advisor who serves first and foremost as a* ***fiduciary*** *– one who places your interests and needs above all other considerations.*

The word fiduciary is rooted in the Latin word *fiducia*, which means "trust." Under a fiduciary standard, any practices that violate the trust a client has placed in an advisor, such as commissions or revenue schemes preferring certain investments, must be eliminated. Investment decisions should be based on their merits alone as they relate to the client's priorities. A fiduciary acts in a careful manner as if the money he manages is his own, and his actions are only an extension of the client's interests. A fiduciary treats investment management as a professional vocation, not just as a business to maximize revenue from clients. The fiduciary advisory has the mentality that he also is a principal owner of the wealth he manages for the client.

INVESTMENT FIRMS AND FIDUCIARY PRACTICES

Given how high fiduciary standards are for investment managers, it is no surprise that many so-called "advisors" do not subscribe to a fiduciary standard of care. Unlike the medical or legal industries, which require professional certification in order to practice, the investment industry remains open to all comers. This explains why the investment industry seems more dynamic than officially licensed industries. It also explains why the industry can be fraught with perils for unsuspecting investors.

Brokerages, Mutual Fund Firms and Wealth Platforms

Investment advisors that are not always bound by fiduciary standards include those at brokerages, Wall Street banks, mutual fund companies and some of the wealth platforms at major national banks. There is an inherent tendency for these organizations to maximize their shareholders' returns, sometimes at the expense of their clients' investment results. Investment performance is important because it helps drive product sales. These companies aggressively sell investments with impressive recent track records, often just before such investments go out of favor. Investing client wealth near the top of an investment strategy is a surefire way to miss client objectives or permanently destroy wealth.

Independent RIAs

Independent firms, such as registered investment advisors (RIAs), consultants and multi-family offices, tend not to have product-driven conflicts of interest because they rarely create their own vehicles for promotion to

Evaluation of fiduciary standards at investment firms

TYPE OF FIRM	EXAMPLES	DEGREE OF ALIGNMENT	FIDUCIARY STANDARD	POTENTIAL FOR CONFLICT OF INTEREST	VALUE DELIVERED TO CLIENTS
Discount Broker	E-Trade Schwab TD Ameritrade	Very Low	None	High. Incentives to use firm's products, often aggressively marketed.	Performance vs benchmark
Mutual Fund Firm	Fidelity BlackRock PIMCO	Low	None	High. Firm will push own product, sometimes exclusively.	Performance vs benchmark
Brokerage Firm	Merrill Lynch Morgan Stanley Wells Fargo	Low	None	High. Firm will push own products, or those in which it has economic interest. Brokers are incented by commissions to trade certain products.	Product offerings
Wealth Platform	BNY Mellon Northern Trust USTrust	Moderate	Some	Moderate. Firm may put client in own products, and offer investments in which it has economic interest.	Client service, product offerings, wealth planning
Independent RIA	Ballentine Partners Brown Advisory SCS Financial	High	Some	Low. Some firms have own mutual funds or investment strategies that are marketed to clients.	Client service, performance vs benchmark, wealth planning
Independent Trust Firm	Bessemer Trust Fiduciary Trust Webster Private Bank	Very High	Always	Very low. No internal products. Firms are held to statutory fiduciary standard by US Dept of Treasury.	Client service, goal-based investment results, wealth planning, education and coaching

clients. These organizations are mostly aligned with client interests and some are staffed with CFAs, CFPs and other qualified professionals. However, clients may encounter a unique conflict of interest in smaller, boutique firms – many of these firms exist mainly to maximize the founder's personal net worth.

> *There is a tendency for fast-growing firms to prioritize sales and marketing over investment management. This can result in underinvestment in client service and portfolio management systems and personnel.*

A sales-driven, boutique culture does not create an immediate risk to client capital, but rather fosters an environment in which advisors may be too consumed with business development to focus appropriately on each client's wealth.

Trust Banks / Fiduciary Firms

Trust banks face some of the most stringent rules and employ the highest standards of fiduciary practice in the investment industry. Trust banks are governed by Reg 9, a rule that determines how banks may serve as investment managers for clients. The US Treasury Department enforces Reg 9 and conducts annual audits of the investment management activities in banks. A key element requires firms to demonstrate that they regularly review whether investment assets are appropriate for the client. Also, under Reg 9 trust banks cannot create their own investment products – an important factor that maintains alignment with client interests.

Trust banks are distinct from the investment groups within large Wall Street banks or wealth platforms, which often are separate entities from the banks themselves and, thus, neither are governed by Reg 9 nor practice its strict fiduciary standard. The guiding principle of the trust bank investment group is to preserve and maximize client's wealth by delivering absolute returns that meet client goals. They are motivated to ensure that the structure of accounts is both cost and tax efficient, and they do so by maintaining close oversight of trust, retirement and agency accounts to ensure they meet their objectives.

HOW A FIDUCIARY ADDS VALUE

Advisors may add value to client wealth in multiple ways: asset allocation, security selection, market timing/tactical investing, expense and cost management, asset location, behavioral coaching and spending strategy. The advisor should aim to maximize net returns, after expenses and taxes, and not take unnecessary risks to achieve an apparent, short-term "market beating" return in a given year. A fiduciary's results will be the by-product of a focus on several wealth maximizing processes. Short-term performance should not drive the investment process.

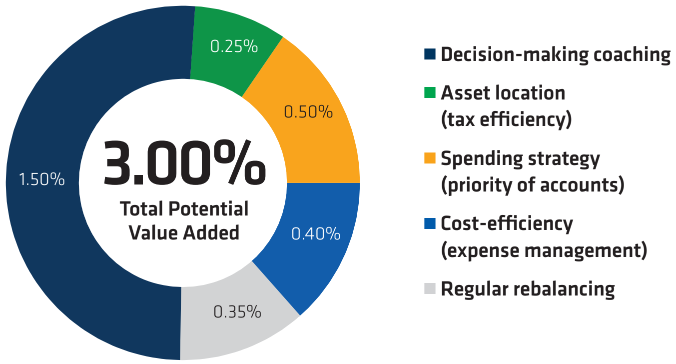
Value-Adding Activities

Asset allocation is the most impactful decision and one over which the investor and the advisor have significant control. It is crucial that the advisor demonstrates how she will remain focused on adhering to the asset allocation even when faced with disappointing short-term results. It is important not to be swayed by yearly results, which will vary greatly from the actual long-term compound return that is generated. Investment results are almost never received in a smooth, linear manner. During the past thirty years a 60/40 US stock/bond allocation has delivered a compound return of +9.2%. However, calendar year results ranged from a high of +30.5% in 1995 to a low of -24.4% in 2008. Only two years delivered a result within +/-1% of the 9.2% long-term annualized return: +10.0% in 2004 and +9.5% in 2016.

Security selection competence is an important criterion, but a secondary one to a well-diversified portfolio. There is little incremental value that an individual security can add to a portfolio, and an advisor would have to deliver an unbelievable batting average of outcomes for all individual securities to out-perform consistently every time. Market timing, or "tactical asset allocation" as it is currently called, leads more often to the destruction of wealth via turnover, transactions costs, and inevitable timing mistakes.

The experienced fiduciary has many tools to maximize the value of the client's wealth, independent of what the capital markets deliver. Close expense management, selection of low cost securities and funds, regular rebalancing, coaching to prevent emotionally reactive decisions, tax efficient asset location and a well-planned spending strategy can all contribute significant incremental returns to the client's wealth. The potential additional value far exceeds the annual management fee of 1% that an advisor typically charges.

Wealth Maximizing Activities



Source: Vanguard, "Putting a value on your value: Quantifying Advisor Alpha," Sep 2016.

Guarding Against Costs

Understanding how your advisor receives compensation, plus examining the other channels that extract fees from your account, requires multiple avenues of inquiry. It is not just about the headline management fee that is disclosed. Your portfolio consists of many line-items, each of which may bear its own internal costs, as well as costs that are incurred when your money moves in and out of investments.

Explicit costs include the headline management fee charged by your advisor, plus commissions charged for security transactions. These costs normally are deducted directly from your account and are readily visible. A management fee charged as a percentage of assets should work to your advantage if your advisor acts as a fiduciary. She will be motivated to minimize transactions and keep all underlying costs low so that results after her management fee are maximized. This leads to accounts with lower turnover or "churn," often less complexity and fewer line items, and the selection of lower cost investments such as individual securities, ETFs and index mutual funds. The investment portfolio should be transparent and reasonably easy to understand. Without special commissions or other economic incentives as distractions, your advisor may focus impartially on long-term asset allocation, security selection and intelligent rebalancing – all worthy activities that add incremental value to your wealth.

Implicit costs include expenses which are not explicitly charged to your account but can decrease your wealth. For individual securities, the main implicit cost is the difference between prices that brokers offer buyers and sellers (the "bid-ask spread"). This cost is usually negligible for exchange-traded securities, but can be as high as 1% to 2% of values for individual bonds traded through dealers. The underlying ETFs or mutual funds in your portfolio have their own fees and expenses, which vary depending on the share class into which your wealth is invested. A fiduciary advisor will avoid high-priced share classes, surcharges on purchases and sales (called "loads" in industry jargon) and funds with expenses that are significantly higher than comparable investments. Clients that dabble in private placement alternative investments face a plethora of fees and charges that are deducted from the limited partnerships in which they invest. Charges include management fees on uninvested capital, deal fees, investment banking advisory fees, various layers of commissions, travel and research expenses, plus performance fees (known as "carried interest"). Many of these are not disclosed upfront and require parsing sections of financial audit documents, offering memorandums or partnership agreements.

The Cost of Going It Alone

Lest one be tempted to go it alone, we remind the reader that many costs apply to the do-it-yourself (DIY) investor also. The obvious cost that one may avoid is an advisor's management fee. The DIY investor might believe that eliminating the fee delivers a higher return on his capital. He would have to defy all odds to achieve this.

Not surprisingly, the track record for DIY investors substantially under-performs the markets. Individual investors seem to fall prey to their own emotional behavior in investing – adding to investments near the top and selling out near the bottom. Long-term studies have found that investors capture just over half of the stock market's return and miss the lion's share of the bond market's results.

For the ten years ending December 2015, equity fund investors earned an annualized return of +4.23% versus the S&P 500 index's return of 7.31%. Fixed income fund investors earned +0.39% annualized, versus a return of +4.51% for the Barclays Aggregate bond index. A 60% stock and 40% bond allocation translates these results to +2.69% for investors vs. +6.19% for the markets, an annual performance gap of 3.50%. The performance gap is many times a typical investment advisor's fee of 1%. Studies include professionally-managed portfolios and automatically rebalanced ones, such as 401(k) and IRA accounts. Thus, the return shortfall is likely even worse for DIY investors, who often operate without a disciplined process.

The Cost of Going It Alone

	Investor Actual Returns		Market Returns	
	Equity Funds	Fixed Income Funds	S&P 500 Index	Barclays Agg Bond Index
Annualized Returns	+4.23%	+0.39%	+7.31%	+4.51%
60% Equity / 40% Fixed Income	+2.69%		+6.19%	
Difference (Investor – Market)	-3.50%			

Source: Dalbar, "Quantitative Analysis of Investor Behavior 2016," dalbar.com. Data are based on 10 years ending Dec 2015.

HIRING AN ADVISOR

Hiring an advisor requires asking questions that are not to be found in standard promotional materials. It is important that the client focus on the fiduciary aspects of the advisor's business and not be led astray by impressive track records, pedigree or fancy offices.

We have prepared this simple questionnaire to use in your search for an advisor. The purpose of the questions is to generate honest and open dialogue. The answers to the questions should clarify whether the person who will manage your wealth will put your needs and interests first.

ADVISOR QUESTIONNAIRE – THREE IMPORTANT QUESTIONS

1. Are you a fiduciary, and bound to act in my interests first?

- How will I know this?
- Demonstrate and prove it.

2. How do you get paid?

- Do you receive any economic consideration for investments in which you place my wealth?
- Show me all potential costs, aside from the explicit management fee, that flow out of my account.

3. How will you add value to my wealth?

- Asset allocation, security selection, market timing
- Best practices (cost/tax efficiency, rebalancing, education and coaching)

CONCLUSION

Hiring a steward of your personal wealth can be a daunting task, but with thoughtful planning and foresight, such as the simple questionnaire and comparative table here, you can be prepared. Fiduciary organizations staffed by experienced, qualified professionals meet the highest standard of care of your wealth. This fact alone improves the odds of success for your financial goals. It outweighs the allure of high-performance track records or prestigious-sounding backgrounds that so often fail to deliver on their promises. Hiring a professional to care for your wealth is nearly as important as hiring a doctor to care for your health. Most investors plan to enjoy the fruits of their wealth and intend for it to outlive them. If this is the case, then take care to hire those firms and people who, like a doctor, view investment management as a serious vocation and will manage and grow your wealth as trusted stewards.

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We want you to be successful. If you would like a copy of the questionnaire and table included in this newsletter, please contact Peter Gabriel, Head of Private Banking, at 203-328-8110 or pgabriel@websterbank.com.

TO VIEW A MORE DETAILED DESCRIPTION AND ANALYSIS OF THESE INSIGHTS, VISIT WWW.WEBSTERBANK.COM/PB.

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