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Mentor Monthly Missive

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Can you trust your financial advisor?

It seems that we hear news every week of yet another financial institution or advisor being accused or found guilty of stealing money from clients' accounts. The $50 billion Ponzi scheme perpetrated by Bernard Madoff has been in the news for a while. The Stanford Group was accused earlier this year of $8 billion of fraud against its clients.

Even NAPFA firms have not been above the fray. NAPFA – the National Association of Personal Financial Advisors – is the national organization for "fee-only" financial advisors such as Mentor Capital Management and holds its members to the highest standards in the financial services field. Despite these standards – including a fiduciary oath to act in good faith and in the best interests of the client – serious charges have recently been made against two NAPFA members, accusing them of stealing money from client accounts.

Whom can you trust these days? How do you find a financial advisor who won't do you wrong? Here are some tips to help you out:

1. Find out all you can about the backgrounds of the advisor and his/her firm. For Registered Investment Advisors (such as Mentor Capital) read the firm's Form ADV on the SEC's website (www.sec.gov.); for brokers (Registered Representatives) go to the FINRA "BrokerCheck" at www.finra.org. These websites allow you to find out many things about a firm and advisor, including any disciplinary history.

2. Ask the advisor about his/her background, experience, credentials, professional designations, and compensation methods. Do further research about what a professional designation means if you aren't clear. Find out about any potential conflicts of interest the advisor might have – such as receiving commissions, referral fees, bonuses or vacations for selling certain products.

3. Ask the advisor for a list of client/customer references, especially people whose situations are similar to yours. Contact those references and ask them questions about their experiences with the advisor.

Clicking on the "Consumer Information" link on NAPFA's website (www.napfa.org), followed by the "Tips And Tools" button will lead you to a "Financial Advisor Checklist" and "Financial Advisor Diagnostic" that provide you with many questions you should be asking.

If an advisor is hesitant, evasive, or confusing when answering your questions, let that be a big warning sign that you should look elsewhere for your financial advisor.

We here at Mentor Capital take our fiduciary oath very seriously, and we also adhere to a strict code of ethics. Our firm, and each of our advisors, take pride in the fact that we have always worked in our clients' best interests and that our professional records are "as clean as a whistle".

While it is important to conduct due diligence when selecting an advisor, it's just as imperative to "trust but verify". Review your account statements and trade confirmations on a timely basis, and immediately contact your advisor if you see any account transaction that looks unusual or suspicious to you.

Actively managed funds underperform benchmarks

Standard & Poor's Index Services (S&P) recently released data showing how some of its indexes performed, compared to actively-managed mutual funds, for the five-year period from 2004 through 2008. The data showed that:

- The S&P 500 index outperformed 72% of actively-managed large-cap funds
- The S&P MidCap 400 index outperformed 76% of mid-cap funds
- The S&P SmallCap 600 index outperformed 86% of small-cap funds

Those results were similar to that of the previous five-year period from 1999 through 2003. In addition, S&P's research showed similar results for international equity funds and fixed income funds.

Many investors and professional money managers believe that actively managed funds outperform their respective indexes during bear markets like the two we've had in the past decade. However, results of the past 10 years prove differently.

We're not surprised by these results, which show that <u>active</u> portfolio management generally is not as successful as <u>passive</u> portfolio management. What are the main differences between the two?

- ***Active*** management includes trying to predict which individual securities or market sectors will do better than others, and trying to time the ups and downs of the markets. (Trying to "beat the market".)

- ***Passive*** management follows a "buy-and-hold" approach through bull and bear markets, primarily using index or passively-managed funds. In other words, you're not trying to time the market or predict which stocks or bonds will do best.

Mentor Capital strongly believes in the benefits of passive portfolio management, and the results of the S&P data help to confirm our convictions. Our passive management approach provides an advantage to our clients by keeping portfolio expenses and turnover to a minimum, which over the long run help our clients earn higher investment returns.

Is your HELOC at risk of being closed, frozen, or reduced?

Home Equity Lines of Credit – HELOCs for short – are used by many homeowners to finance home improvements, pay off other debts, or as an emergency fund. The relatively low interest rates and rising home values of recent years made it easy for many homeowners to tap in to these accounts when needed.

How times have changed. As home values have declined in recent times, many lenders have surprised their customers by freezing, reducing, or even closing their HELOC accounts. These homeowners are adversely affected in more ways than one; not only does the customer lose access to emergency funds during a bad economic downturn, but the account closing can reduce the customer's credit score.

Why would the closing of a HELOC hurt your credit score? Some credit score formulas are based in part on the ratio of your outstanding debt to your available credit. If your HELOC is closed, your total available credit declines and your "credit utilization ratio" rises. (Some lenders now use newer credit score formulas that don't include HELOCs in these ratios.)

The Federal Deposit Insurance Corporation (FDIC) provided some guidance to lenders last year on working with customers when reducing or suspending a HELOC account. The guidelines include a reminder that certain legal requirements designed to protect consumers must be met, and urge lenders to work with borrowers to minimize financial hardships resulting from suspensions or reductions.

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