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June 2013

Hurry Up and Wait — For Washington D.C.

This Newsletter was inspired by a Rotary Club meeting during which Hamilton Point team member, Nate Byrd, was asked whether our company was, in the spirit of Rotary, truly "beneficial to all" and how we managed to balance the interests of customers, employees, shareholders and society. Nate cited our independence and the fact that we "eat our own cooking" by personally investing alongside our clients, but the question deserves a longer explanation than was suited to that venue.

In this Newsletter we review ever-pending financial regulation in Washington D.C. and expose unseemly transactions between brokers and their bosses during the financial meltdown—activities that demonstrate to us that there is a wide range in how "beneficial to all" different classifications of financial advisors may be. We wrote about this in our May 2010 Newsletter, "Wall Street Transparency…Clear as Mud" but feel that Washington's inaction since then and the continued debate about how to regulate the investment industry deserves emphasis.

Two Eyes Seeing Separately

One area where Congress has not completed its work (i.e. has yet to collect its full measure of lobbyist money?) is the debate over regulation of brokers and independent registered investment advisors. Brokers, like Merrill Lynch or Morgan Stanley Smith Barney, are regulated by FINRA[1] while registered investment advisors ("RIAs") of a certain size, like Hamilton Point, are overseen by the Securities and Exchange Commission ("SEC"). One of the key regulatory differences between brokers and investment advisory firms like ours concerns the fiduciary standard. To simplify, brokers can sell products to clients as long as they are deemed "suitable" and the client is given adequate disclosure, while investment advisors like Hamilton Point have a fiduciary responsibility to recommend investments that are in a client's "best interest."

There are many genuinely good professionals serving as brokers and they play an integral role in the industry. We do not intend to imply that RIAs are "better" or "more qualified"— in some cases, they clearly are not. There is, however, a critical difference we believe between a financial advisor that is a salesperson for a brokerage firm under a suitability standard (earning commissions from products—stocks, bonds, mutual funds, insurance) and an independent, fee-only investment advisor with a fiduciary standard (earning fees that are not based on the investment recommended to the client).

We believe the financial crisis of 2008 proved that the legal difference between selling what is "suitable" versus what is in a client's "best interest" is large enough to drive a Mack truck through—or should we say a Brink's truck in this context. In the lead-up to the financial crisis the big banks' and brokerages' investment banking departments generated billions worth of esoteric asset-backed securities which they asked their affiliated brokers/financial advisors to sell to clients. Needless to say, thousands of upstanding brokers were crestfallen to witness the meltdown of those investment products, especially since many were promoted as relatively safe.

Naturally, many clients lost faith in these large firms that were teetering on bankruptcy and also negotiating with

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1) The Financial Industry Regulatory Authority, Inc. ("FINRA") is a private, independent and nonprofit self-regulatory organization that assists the U.S. Securities and Exchange Commission ("SEC") in regulating financial markets, notably exchanges and companies that deal with securities. Among other duties, FINRA enforces rules, arbitrates disputes, and provides training and licensing services. It was created in 2007 with the merger of the National Association of Securities Dealers and the New York Stock Exchange regulatory board.

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Washington for TARP[2] bailout money in late 2008. Meanwhile, many brokers started leaving those organizations to start their own advisory firms or join independent groups like Hamilton Point. But wait… if too many high-producing brokers exited (presumably to serve their clients' interests better), then insolvent brokerages would become even more broke, and Washington would be on the hook for even more debt! But, alas, one should not underestimate Wall Street's ability to craft financial solutions to most any problem.

Haggling Over the Price

Since the large brokerages literally could not afford to see their best advisors exercise their right to freely walk out the door, they offered them substantial "retention bonuses" if they would stay[3]. Specifically, select brokers were paid lump sums structured as "loans" to be fully forgiven if the broker stayed on the job for a period of years. Many brokers—in the midst of a crisis themselves—were financially vulnerable to these cash payments.

If brokers being paid to keep their clients at a troubled firm does not present a conflict of interest, then we do not know what does. Amazingly though, these transactions did not have to be disclosed to clients even though the payments, it seems to us, effectively encouraged brokers not to look out for their clients' interests.

In returning to Nate's Rotarian questioner, we sense that he—like so many Americans—generally holds financial industry participants in contempt based on reputations that we believe traditional Wall Street firms have spent decades "earning" through actions such as these, often at the expense of their clients.

Rotary Spin

As for Hamilton Point's answer to the excellent question Nate received at the Rotary meeting, we offer the following on how we balance the interests of customers, employees, shareholders, and society. Firstly, Andrew Burns and Rick Woods, the writers of this missive, can speak for three of the named constituencies since we are customers, shareholders and employees of Hamilton Point. As mentioned earlier, our personal investments are invested in the same securities recommended for our clients. More broadly, a primary goal at Hamilton Point is "100% client retention," something we believe we can achieve if we produce desired investment results and service clients proficiently.

Harder to answer is whether Hamilton Point benefits society—something we believe we do. The money we manage is for individuals and foundations who we believe value our focus on quality and efforts to invest in well-managed companies. We annually evaluate the sustainability efforts of each of our Global Core Equity Strategy holdings[4], and do consider what type of "corporate citizen" a company is in evaluating the quality of their management team. Our quality-driven strategy also leads us to own companies that we believe sell value-added products and those that increasingly provide global consumers with comforts such as better personal dental care, elevators and air-conditioning.

While we do not agree with **Goldman Sachs** CEO Lloyd Blankfein's comment that we are "doing God's work,"[5] we do feel appreciated by our clients. We believe firmly that clients are fortunate to find a truly independent firm like Hamilton Point where research is conducted in-house and we take seriously our fiduciary level of duty when serving clients.

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Hamilton Point Investment Advisors is an independent and independent-minded wealth advisory firm. Please contact us for a complimentary review of your portfolio. In addition, visitors to the firm's website, www.HamiltonPoint.com, can read past investment newsletters.

2) Troubled Asset Relief Program ("TARP") is a program of the United States government to purchase assets and equity from financial institutions to strengthen its financial sector.
3) "Bonus Blowback Bypasses Brokers." *The Wall Street Journal.* 2/25/2012
4) 2012 Global Sustainability Report reviews the sustainability efforts of the Global Core Equity Strategy companies and is available upon request.
5) "I'm Doing 'God's Work'. Meet Mr. Goldman Sachs." *The Sunday Times* (London). 11/08/2009