

notes from the assabet

Second Quarter, 2010

Volume VIII no. 2

Victims of Wealth

It's not a new concept that wealth does not always bring happiness. It's as old as the story of King Midas whose greed for riches caused him to turn his beloved daughter into gold. It's as ancient as the warning, penned back around 64 A.D., that the love of money is the root of all kinds of evil. But only recently have we had a field of study and practice devoted to this understanding: "Wealth Psychology." Today, you can find psychologists to help you with your money "issues," as well as financial advisors with a specialty in dealing with the suddenly rich. Some wealth management firms have even added psychologists to their staffs.

American culture in our time is the obvious environment for wealth psychology to blossom. We may not be unlike previous cultures in which people observed the very wealthy with both longing and contempt. That dysfunctional ambivalence is not new. Yet in the past few decades, the accumulation of great and sudden wealth has been more possible and prevalent.

It's the abrupt transition into wealth, through inheritance, lottery winnings, or a dot.com level of business success that is the major focus of wealth psychology. The disorder, "Sudden Wealth Syndrome," has been summarized by one expert as "the despair of having gotten what you want."¹ Few people can summon copious tears for the victims, because we all harbor the belief that sudden wealth would be fantastic. But getting beyond the temptation to be sarcastic about these poor suffering souls, we can look at how sudden wealth actually can be a problem.

Lottery winners, whose numbers include many people with no previous experience with affluence, and who have the least warning of impending riches, may have the most misery. Having believed that money would solve their problems, they encounter instead new ones: alienation from their accustomed lifestyle and friends, an avalanche of solicitations from family, friends and strangers, and stress from having to make decisions for which they lack preparation. Many, in the euphoria of their dream come true, and lacking an understanding of precisely how wealthy they are, blow right through the money and end up in poverty, or worse. (Jail is worse.)

Among those attaining sudden wealth, the lottery winners are the least likely to seek psychological help. But take note of this advice from "sudden wealth" advisors, in case your number comes up:² 1) Do not immediately collect, thereby making your winning public. You need time to absorb it before the deluge of attention. Make copies of the winning ticket. 2) Consult with a financial advisor to understand the dimensions of your windfall. 3) Set a DFZ (Decision Free Zone) during which time you make no spending or charitable decisions. 4) Create an advisory group to help you manage financial and lifestyle decisions in the first year or two. You might even join a support group like the "Winner's Circle," an Ohio based group for lottery winners.

Those who are catapulted to sudden wealth by working in a business that explodes are somewhat different. What happened to them was slightly

Continued p. 2



Lisa Phelps & Wayne Ushman



Assabet Advisors is an independent SEC Registered Investment Adviser, seeking sound and customized investment solutions for high net worth individuals, businesses and foundations.

Focusing our business on larger portfolios, we are able to offer our clients highly flexible services and frequent communication.

We are among a limited group of fee-based advisors who are approved for access to the funds of Dimensional Fund Advisors.

4 Smith Road

Northborough, MA 01532

Tel: 508-351-9666

Fax: 508-351-9689

wushman@assabetadvisors.com

lphelps@assabetadvisors.com

WWW.ASSABETADVISORS.COM

Copyright © 2010 Assabet Advisors, LLC



Victims of Wealth, continued

less of a long shot than winning the lottery, yet it leaves them dislocated in similar ways. There is guilt (“Why am I entitled to this?”) a sense of purposelessness (“I don’t have to work anymore.”) and the disorientation that comes when moving away from the neighborhood, people and lifestyle they’ve known. Many make key decisions before completing the “identity consolidation stage” in which one comes to terms with being wealthy, decisions that should wait until the “stewardship stage” when they have achieved mature resolutions about what the money means to them. Too early in the process, the suddenly wealthy may flit between contradictory resolutions: “I’m still a regular guy and won’t leave my current house,” “I can afford the Ferrari,” “I’m going to give a lot to charity,” “I’ll still work,” “I’m taking the family traveling for a year...”

Inherited wealth is different, not only because the recipient probably experienced a wealthy lifestyle growing up, but because it can be foreseen. Affluent parents can prepare their children for wealth by teaching values and skills that will enable them to use wealth constructively rather than destructively. In the words of one advisor, “wealth should be fertilizer, not gasoline.”

Despite this lead-time advantage, many heirs do crash and burn. Trust fund babies may feel guilt and shame for having wealth that they themselves did not earn. (In fact, one lab study showed that the brain is more stimulated when the subjects had worked for their money rather than winning it or receiving a corporate windfall.⁴) Heirs may suffer from a sense of worthlessness because work is not a necessity. Some experience a sense of invincibility and an increased appetite for risk, leading to more dangerous leisure activities (heli-skiing, rock climbing, for instance)⁵. Wealth psychology suggests that money, unaccompanied by solid values and training can lead to “affluenza,” whose major symptoms are an inability to delay gratification, a loss of motivation and a sense of entitlement.⁶

Perhaps wealth does not buy happiness, but it is generally connected to happiness in these ways⁷:

1) The lack of money can cause unhappiness, but once basic needs are met, more money, on its own, does not increase happiness. In fact, the more money you have, the less effective it is at increasing your joy.

2) People who are happy already (because of stable intimate relationships, a sense of purpose, and a lack of stress regarding kids and work, etc.) may become more happy with greater wealth.

3) Doing things is a more powerful happiness factor than having things. The lesson? Spend money on a family vacation before spending on new possessions.

If you’re like most people, you know it is true that money cannot buy happiness and, indeed, that sudden wealth can cause great unhappiness BUT you don’t believe it would be true for you. If offered a huge windfall, you’d say, “Bring it on!”



If you want to test your readiness to deal with sudden wealth, do a web search on “QUIZ: Would Riches Ruin You?” bankrate.com. If you do well, go ahead and buy a lottery ticket, but keep the name of a good wealth psychologist on file.

¹P. Carbonara, “Heal the Rich,” cnnmoney.com, 5/1/00, ²S. Bradley, Sudden Money, 2000, ³“Sudden Wealth Syndrome, Registered Rep.com, 4/1/05, ⁴“Easy Money,” empowereddoctor.com, ⁵K. Clouse, Sudden Wealth Syndrome,” msmoney.com 7/6/06, ⁶D. FDutrelle, “Can Money Buy Happiness?” CNNMoney.com, 7-18-06, ⁷J. MacDonald, “Avoiding Sudden Wealth Syndrome,” bankrate.com, S. Vedantam “You Really Can’t Buy Happiness,” Washington Post, 7-3-06, M Berton, “Lottery Winners Face Challenges,” 7-28-03



In Your Best Interest

Sec 913 is a small part of the 2000-plus page bill recently approved by a House-Senate conference committee, but it's the section that kept lawmakers up until the wee hours of June 25 as they ended a 20 hour session to reconcile the House and Senate Wall Street reform bills. It's also a section of critical interest to all professional investment advisors. It would be important to their clients as well if they only understood its subject matter.

Sec. 913 relates to the standard of care financial advisors owe their clients. Few investment clients are aware that today, in moving from a registered representative of a broker-dealer ("a broker") to a Registered Investment Advisor ("RIA"), they actually are moving from one standard of advisor care to another. (In fact, some advisors are dually registered and can operate under one standard with one client, and the other with another client.) A broker operates under a standard of "suitability". Suitability requires that the broker knows enough about the client, the goals of an account, and the security to judge if an investment is appropriate to the portfolio's goals. Suitability does not require anything about what benefits the broker might glean from the security's selection.

A Registered Investment Advisor (Assabet Advisors) operates under a "fiduciary" standard, and is legally required to place the client's interest *before his own*. RIAs must fully disclose how they are compensated and whether or not they have any conflicts of interest in regard to the selection of securities. An RIA is obliged to seek what is best for the client, not merely suitable. Example: A refrigerator salesman knows that you want a stainless steel, side-by-side fridge with a capacity of at least 28 cubic feet. Any product with those features is "suitable," including the one that costs 25% more because of a higher sales commission or the one that helps the salesman score higher in a competition. It is suitable, but not in the customer's best interest. Of course, that a broker need not meet a fiduciary standard does not mean that all brokers consistently put their own needs ahead of clients' needs, simply that it is acceptable by the suitability standard.

The final "Dodd-Frank" bill (for Chris Dodd and Barney Frank) was approved by the House and will be voted on by the Senate this month. It will require the SEC to conduct a 6-month study to evaluate the existing standards of care and how well they protect the retail customer receiving investment advice, and it empowers the SEC to write a regulation regarding standards of care, potentially creating a universal fiduciary duty. Stay tuned.

"Congress passes Fiduciary ball to SEC," [Investment News](#) 6/28/10, "The F-Word Stirs up Controversy," [onwallstreet.com](#), 7/1/2009, "New Hurdles for Wall Street Reform," [cnn.com](#) 6/28/2010

Quarterly Economic and Financial Review

By May, 2010, our economy had been in a slow recovery for about a year, buoyed by improvements in the world's credit markets that made borrowing cheaper and easier for corporations. Following a decline of nearly 60% during the financial crisis, U.S. stocks began to climb in March, 2009 and had grown by more than 50% by this past May. Investors were encouraged by slowly expanding corporate and consumer spending, healthy corporate profits, growth in manufacturing and a slight decrease in unemployment. However, by the end of June, that optimism had disappeared. The domestic stock market (S&P 500) was down -4.85% on a year-to-date basis, and international stocks (EAFE Index) by -11.67%.

Investor confidence was weakened by a plunge in new home sales and uninspiring employment data. The Consumer Confidence Index dropped 10 points to 52.9 in June. Credit conditions worsened with concerns about possible contagion from sovereign debt problems in Europe. Rising spreads between the corporate debt and Treasury debt rates reflected a growing aversion to risk. While economy still appears to be in recovery mode, the pace of improvement has decelerated. Gross domestic product grew by 2.7% in the first quarter (revised down from initial reading), slower than expected.

Fed Chairman Bernanke asserted that we are not experiencing a double dip recession. At this point the economic recovery has slowed but not stalled. Conditions certainly are far from the crises in credit and in economic growth seen in 2008-2009. However, our government needs to deal with the impact of unprecedented economic stimulus programs, some day implementing tough fiscal measures. This will be hard to do within a fragile economy. We need rising confidence in both businesses and consumers in order to bolster economic growth that is self-sustaining, not propped up by the government.

We also need investor confidence to pull the stock market out of recent doldrums. Some analysts claim that we're in a correction still within a bull market and that prices are low currently. In May and June, most investors weren't buying that.

The Bond Guy

Bonds are a part of nearly all of our client portfolios because they offer diversification from equities as well as regular cash flow through structured maturities. For Wayne, bond purchasing is the part of his job that he loves to hate because it can be discouraging and frustrating. But then there are those moments when, as a result of tenacious searching and negotiation, he lands an especially good one for his clients, making it all worthwhile.

Aside from using funds to provide access to international and high yield fixed income markets, Wayne tends to buy individual bonds rather than bond funds (for certain portfolios, funds make sense) and he doesn't trade actively but buys and holds. He doesn't believe that for our purposes, it pays to make bets on interest rates. Instead, he buys bonds of different maturities within the short to intermediate range so that he has a "ladder" of bonds maturing over time, thus providing some protection against interest rate risk. For our practice, he doesn't think it would add value to take chances on credit quality so he tends to stick with highly rated (or insured) municipal bonds for taxable portfolios, and Treasuries or government agencies for untaxable portfolios. The process involves internet searches to locate attractive bonds, then negotiating a price with a dealer. The process calls on his past experience with multi-billion dollar portfolios. It is invisible to the clients, yet it adds value to their portfolios.

That's Wayne's approach, and how it works in the best of all worlds. You may have noticed that we are not in the best of all worlds, particularly in bondland, as interest rates are remarkably and persistently low. The Federal Reserve can manipulate short term rates but rate reduction has occurred also all along the yield curve. As a result, Wayne has had to venture out of the box described above. What follows are some of the interesting detours he has taken from the normal path:

- 1) In 2009, Wayne began buying MA Turnpike bonds that had longer maturities than his usual targets (but could be "called" well short of the stated maturity). They were rated investment-grade, but were selling at a significantly depressed price, reflecting investors' concerns about credit quality. Wayne decided that the Commonwealth would not allow a default on these bonds as it would damage all other offerings bearing the name "Massachusetts." The yield was considerably higher than other bonds of the same rating and maturity. Recently, the bonds were called, and Wayne was paid at par, a level considerably above his purchase price. A win! Now he has all of that cash to reinvest.
- 2) Wayne has begun to buy secondary CDs, or those sold not by the bank of issue, but by a reseller. These CDs have yields that compare favorably to newly issued CDs of the same issuer, and even to tax-exempt securities. They were issued by banks of a decent quality level and have the protection of FDIC insurance. As secondary issues, these CDs are liquid. Wayne makes numerous calls to the dealers each day because he needs to be persistent, even a pest in this very competitive environment.
- 3) Because interest rates currently are so low (nowhere to go but up!), and because we anticipate an acceleration of inflation, we expect rates to rise. When rates climb, bond prices drop, reducing the portfolio's market value. No one is sure when this is going to happen and, in fact, it's overdue by most forecasts. In any case, Wayne is wary about this threat. Recently he has added Fidelity's Floating Rate High Income Fund to many client portfolios. We don't use bond funds generally. They have no scheduled maturities providing cash flow and the ability to ladder bond holdings as an inflation defense. But this fund is different. It invests in bank loans from well-secured but weaker credit corporations. Their interest rates "float" with LIBOR (London Interbank Offer Rate) and are reset monthly or quarterly providing protection when interest rates rise.

Wayne isn't one to change course for no good reason, but as The Bond Guy, he's willing to be resourceful and adaptable, but not wild 'n crazy, when the circumstances demand.

The information contained herein should not be construed as personalized investment advice. There is no guarantee that the views or opinions expressed in this newsletter will be realized. Assabet Advisors, LLC ("Assabet") is an SEC registered investment adviser. Assabet and its representatives are in compliance with the current registration and notice filing requirements imposed upon registered investment advisers by those states in which Assabet has clients. This newsletter is limited to the dissemination of general information pertaining to its investment advisory services. For information pertaining to the registration status of Assabet, refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). For additional information about Assabet, including fees and services, ask us for our disclosure statement as set forth on Form ADV.