

# Do You Need a Securities License Today?



What drove the bull market in the 1990s? Was it Fed Chairman Bernake and the Fed's policies? Was it President Clinton and his policies?

There were actually two drivers of the stock market in the 90s:

1. As the baby boomers got closer to retirement age, they began putting money away in 401(k)s, IRAs, and mutual funds. The increase in dollars chasing a limited amount of stocks drove up prices — a result of supply and demand.

2. In 1986, President Reagan instituted tax reforms that did away with most all the tax shelters people had been using throughout the late 1970s and early 1980s. At the same time, he did away with the interest deduction on credit cards and auto loans leaving the general consumer with only the interest deduction for their home mortgage.

This second driver requires a closer look. The 1986 tax reforms led to what became the hottest financial product of the past generation: the home equity loan. Prior to that, if somebody put a second mortgage on their home it meant they were in dire financial straits. After the reforms however, the banking industry re-packaged the second mortgage to create a home equity

line of credit and suddenly it became something smart and fashionable. Bankers were recommending home equity loans. Why? Because they had low loss ratios. CPAs and tax advisors were recommending home equity loans. Why? Because it was the only place they could give you a tax deduction. Financial consultants were recommending home equity loans. Why? So they could use that money for investments and get a commission off of it. Average consumers were using home equity loans like credit cards to finance vacations, SUVs and so on.

Beginning in 1988, America began cannibalizing itself, eating out its equity — equity that had taken decades and generations to accumulate. Hundreds of millions of dollars of home equity went from net worth into expense and debt - and was gone. Home equity loans turned us into this debt-growth/consumption economy. When we compare personal debt from 1980 to 2012 as a percentage of GDP, it has gone from 32 percent to 97 percent. Personal debt as a percentage of net disposable income has gone from 38 percent to the 90 percent range; it's more than doubled.

To tie this into the stock market drivers of the 1990s, all of the consumption generated by home equity loans drove up

stock prices. Combined with baby boomers pouring money into their 401(k)s, these were two major mega-trends taking place throughout the 90s.

However, in spite of what was going into 401(k)s, we were borrowing more than we were saving. While dollars were coming out of paychecks and into 401(k)s, people were actually borrowing more than that from their home equity loans, creating a negative net savings rate throughout that decade.

Now jump forward to present day. The mega-trends of the 90s have created another mega-trend today: the reversal of baby boomer generation assets. They are no longer saving; they're not putting money into 401(k)s. Instead, they're moving from equities into fixed principal assets because they're leaving their capital *accumulation* years and heading into their capital *preservation* years. They're downsizing, deleveraging, getting out of debt, reducing their consumption, and simplifying their lives.

In addition, we have a negative population replacement rate which puts even more downward pressure on consumption. In other words, there are more people dying than buying, more dyers than buyers. Unless the population replacement rate makes a turn for the better, this trend will continue not

only until all the baby boomers have retired in 10-20 years, but until the last of the baby boomer generation is dead and gone some 30 years after the last group has retired.

What does that mean for the stock market long term? We will no longer have this consumption-driven economy. It's the same phenomenon we saw in Japan in the 1990s and the one currently going on in Western Europe. Japan's economy has been flat for 25 years now. This is not a 5, 10, or 15 year phenomenon; this is decades-long issue.

When we meet with retirees, 80% already have their dollars out of the market, and once retirees recognize this phenomena, of the other 20% that still have dollars in the market, 15% want out anyway, so that leaves 5% of their dollars wanting to roll with the market.

### How the Wealthy Invest Differently than the Average Consumer

The wealthy focus on keeping and protecting their principal while the average consumer is focused on returns. In other words, those who have lived their lives spending their money don't have any principal to focus on, and so they focus on getting high returns while those who have saved all their lives focus on protecting what they already have. The savers, the affluent, are focused on protecting their principal — no need for a securities license here.

### Tax Advice

We've talked about the trend reversal in the baby boom generation, and about how there will be more dying than buying for the next 30 years. We've also talked about how the wealthy invest differently since they aren't as concerned about high rates of return. Now let's talk about the tax aspect. They all include a disclaimer at the bottom on their investment statements saying "No Tax Advice — Consult Your Tax Advisor." Why? Liability! This leads us to see client portfolios that are 180 degrees opposite what would be best given their tax situation.

Since the only relevant return is the risk-adjusted, after-tax return, it's important to pay attention to what financial consultants are doing with a client's portfolio. Many consultants make the mistake of advising clients to take on more risk for less after-tax return when they could have gone with a fixed principal product that took on much less risk but generated a much better after-tax return. In essence, they could have taken on a lower risk but netted higher returns. Those who want to work with

upper-asset clients will easily trade giving investment advice to a practice focused on giving tax advice. It sets them apart from the pack, and it's what their clients want.

### Baby Boomers and the Stock Market

Since August of 1982, we've experienced a secular bull market which means we have a generation of baby boomers that know nothing about operating in a bear environment. One of the challenges we face today is dealing with a retirement population that is not prepared to deal with the realities of a bear market. Same with the financial consultants—no-to-little experience in a secular bear market. When their stock brokers and financial consultants say, "Hold on, the market always comes back," the baby boomer group tends to believe them. However, this is a saying that most brokerage firms love to perpetuate. Why?

Self-preservation.

If they didn't perpetuate it, they'd be saying goodbye to all their clients. It would be like Merrill Lynch putting itself out of business every 5 years. The problem is these retirees don't have time to ride 17 years through the bear markets. Remember, they're in the asset preservation phase and can't afford to lose large amounts of capital while waiting for the market to come back.

### The Value of a Referral

If you have a securities license, you can't use client testimonials. What implications would that have on your marketing? How much more money would you have to dedicate to your marketing campaign to make up for not having the benefits of real client testimonials?

A referral brought to you through a testimonial can be invaluable to your company as it can bring in a new client that you didn't have to pay for. In other words, the client you pick up via referral costs you nothing since you didn't have to expend any marketing dollars to get them through your door. The baby boom generation can still depend greatly on word-of-mouth and personal referrals to lead them to their financial consultant. The insurance industry uses client testimonials on TV, in their literature and firm brochures. Securities salespersons cannot do that.

### A Few Final Thoughts to Consider

- What direction is the target market heading as far as the baby boomers' need for securities versus fixed principal?

- Are there others who can provide that service for them? How much do you need to grow or expand in order to provide that service yourself?
- Is a securities license going to generate a net profit or is it more valuable to offer fixed principal products?
- Will a securities license cannibalize your other business by controlling you, tying you down, and prohibiting you from providing tax advice?

Twenty-five years ago the cost-benefit ratio of a securities license was high need, high demand, highly appropriate for our clients in the capital accumulation years of their lives, and comparatively lower regulatory costs. Today that cost-benefit equation has reversed. **If you are going to work with those that have assets, with some wealth, with baby boomers, then you're dealing with 5% of client's that want their dollars in the opportunity side and want 95% of their dollars in the fixed principal side, and the regulatory costs have skyrocketed.** The traditional financial consultant will follow the industry because that's all they know, but the business person will make a smart business decision. Many astute consultants have already recognized this from their gut, if not from the logic above. ☐



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