



# Occam's Razor

May 2012

## WHAT IS OCCAM'S RAZOR?

Occam's Razor is a principle attributed to William Occam, a 14th century philosopher. He stressed that explanations must not be multiplied beyond what is necessary. Thus, Occam's Razor is a term used to "shave off" or dismiss superfluous explanations for a given event. This concept is largely ignored within the investment management landscape. This newsletter will "shave off" popular investment misinformation and present what is important for achieving long-term investment success.

## Goldman's Omertá

We've all been there before. Stuck in a bad job with a horrible boss, dreaming of the day when you could give them a piece of your mind. Most of us have never gone out in a blaze of glory, but recently there seems to be a rash of people making public displays of their resignations. We all remember Steven Slater, the flight attendant who "lost his cool, grabbed a beer, slid down the plane's emergency chute and launched himself into stardom." But it was Greg Smith's resignation letter, "Why I Am Leaving Goldman Sachs" published in the NY Times opinion page that created the biggest splash – so much so that Mr. Smith's letter inspired Darth Vader to write a satirical resignation letter to the Empire.

According to Mr. Smith, "To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money. Goldman Sachs is one of the world's largest and most important investment banks and it is too integral to global finance to continue to act this way. The firm has veered so far from the place I joined right out of college that I can no longer in good conscience say that I identify with what it stands for."

Mr. Smith's holier than thou tirade made Occam's want to gag, and that is putting it lightly. He does deserve credit for publicly piercing Goldman's omertá. But my physical reaction isn't because he's not right; I agree with him wholeheartedly. But this is nothing new. Goldman Sachs has been duping their clients since they've been in business. Just Google "Goldman Sachs History" to see the results yourself.



- Victor Kerlow- The New York Times "Why I am Leaving Goldman Sachs"

What upset me was for someone who bragged about his intelligence, his ultra-exclusive employment, and even his bronze medal for table tennis at the Maccabiah Games (seriously, who references this in their resignation letter?), he didn't understand the fundamental reason why Goldman Sachs never had a positive culture or cared about the best interests of their clients. The reason is simple, and it doesn't take a Stanford graduate or Rhodes Scholar finalist – both of which Mr. Smith is – to understand.

There are two diverging paths in finance. Unfortunately, the financial industry has done a masterful job making it seem like there is only one. Think about

every commercial you've ever seen from household name Wall Street firms. "You and Us, UBS," Merrill Lynch's "A Tradition of Trust," and John Hancock's "The Future is Yours." My personal favorite is the old Smith Barney tag line "Smith Barney, they make money the old fashioned way, they earn it." The irony always makes me chuckle.

I'll try not to dive too deeply into the legal terminology, but indulge me for just a moment. There are three main laws in the financial world that dictate how we are regulated as an industry. The Securities Act of 1933, The Securities Exchange Act of 1934, and The Advisors Act of 1940. The irony of this point is that these laws have been on the books for almost 80 years and were created after The Great Depression. Mr. Smith is familiar with these laws, but clients, who these laws were designed to protect, are still in dark.

The Acts of '33 and '34 essentially created the Securities Exchange Commission (SEC) and required securities issued for sale to fully disclose all relevant information so that purchases and sales were transparent. They regulated the brokerage of securities. In other words, these laws were created to regulate salesmen, not people who provide advice. These two laws together are one of the two paths.

The aforementioned firms have historically been singly registered under these laws. They are essentially your neighborhood butcher shop. You would go to them for meat, but you wouldn't ask them for advice on your diet. The industry term for these people is "Registered Representative." It is parlance for salesmen and it screams conflict of interest.

The other path is the Investment Advisors Act of 1940, which basically requires advisors singly regulated by this act to always work in the best interests of their clients. The 1940 Act seems obvious; if you're pro-

viding advice to me about my retirement, then it had better be in my best interests and not designed to increase your salary. Firms that are singly registered under this law are like your neighborhood nutritionist: you go to them for advice on your diet, not to buy your meat.

If you view your financial life in terms of the butcher/nutritionist analogy, then the decision is easy. The nutritionist is the one who truly works for you. But why isn't it this clear and why are investors still being taken advantage of? Here's the rub.

These firms figured out how to walk down the diverging paths simultaneously. They call it dual registration, which blurs the distinct responsibilities of your local meat merchant and nutritionist. They also figured out how to avoid disclosing in which capacity they are operating; whether they are selling or advising. The conflicts are clear and the ensuing damage these relationships cause are obvious when you understand these distinct paths.

This is precisely why I wanted to gag when I read Greg Smith's op-ed. He knows these laws. He had to know them in order to work for Goldman, as it's a requirement of the registration process.

We understand that you have a choice of who you work with and that you're constantly being solicited. As clients, you should be asking yourself: how do I protect myself, my family, and my legacy from being subjected to a conflicted relationship? And the answer is easy. The next time someone is singing you a siren song, cut them off and ask one question: "are you a registered representative?" By asking this question, you are removing the emperor's clothes and getting straight to business.

Until next month – Occam's

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