THE TYLER GROUP Financial Services

Sound Advice

7 Reasons Why Rich People Like Mutual Funds

By Rod Tyler, CFP, R. F. P. , CLU

In my capacity as a financial advisor over the last 32 years, I have had the privilege of introducing the concept of managed money to many hundreds of individuals and audiences. Although it seems almost incomprehensible in today's ultra-low Interest rate environment, investing in bank, credit union and trust company deposits was once considered the only way to invest. The ultra-high interest rates of the late 1970's and early 1980's made sure of that. As a new advisor starting in the 1980's, overcoming the public's aversion to what was deemed a risky asset (a mutual fund), was a daily challenge. The path of least resistance was to promise the highest available interest rate, even though that often turned out to be not only risky, but just did not deliver any real gains after tax and inflation. In countless now forgotten Canadian newspaper headlines of the 1980's, the reports of the failure of a number of trust companies, credit unions, a life insurance company, a bank and several other financial institutions were very topical news. Eventually most of these needed to be wound up or absorbed into bigger financial institutions. The names **Confederation Life**, **Royal Trust**, and **Principal Group** come to mind, but the list goes on. Eventually depositors were paid back, but some of those deposits were not repaid until years later. I recognize that in the present environment of 24 hour news and the latest apocalyptic headline, that story is now ancient history. However, it does remind you that you can pay a very high price for something that is described as guaranteed. I won't dwell any more on that topic in this article, but for those that are curious about what you really get to keep from your GIC or term deposit, after tax and inflation, here's a link to an article that you will find informative. *"The Lender's Dilemma"*.

So let me now return to the topic of this article, **"Why rich People Like Mutual Funds"**. Before I go further, I would just like to clarify one thing. When I say mutual funds, I am really just using that as a way to describe a managed pool of money. There are lots of sub categories of managed money, including pension funds, but the ones I am referencing all possess the same qualities as I will describe below, and are all part of the appeal of mutual funds.

One of the most fundamental truths about wealthy people is that when they invest in financial assets, they seldom are trying to make a huge return on their investments. They are already wealthy so they don't need to take the risks of losing a significant amount of their capital. What they really want is the following:

1.
Ready access to their money.

The overwhelming portion of wealthy people have made most of their money by owning businesses, professional firms, or non-liquid assets such as farmland, real estate, or have inherited from some family member who made the money owning these same businesses. They already have had a lot of experience being wealthy on paper, but not in readily cashable assets. When they eventually get to sell a business, or save up enough of the earnings from their life's work, they almost always prefer to have ready access to their money. So here is one of the underappreciated qualities of a mutual fund: **daily pricing at the net asset value of your holding**. That is what is referred to in your investment statement as the NAV. At the close of business every day you can redeem all your investment for the value as quoted in the public markets. No waiting for a maturity date. No waiting for the best offer. Just all your money at the price quoted, every day.

2.
Professional money management.

This sounds a bit simplistic, but it really isn't. Most of the wealthy people in the world made their money running a specific business about which they knew about all there was to know, but only in that specific area of activity. For example, they may have started and built a world class software company, or run a construction company. Either way, these business people did not pretend to know everything about such complex topics as professional money management. One of the world's wealthiest people, Bill Gates, has famously outsourced the management of his many billions of dollars of wealth to his own team of professional money managers. He has

CAL FEHR PHOTOGRAPHY

sold most of the Microsoft shares he once owned, and has replaced his concentrated wealth in Microsoft with a diversified portfolio of investments. Warren Buffett has pledged most of his billions of wealth in Berkshire stock to the Bill and Melinda Gates Foundation. After Buffett's passing, that same foundation will gradually sell his concentrated holdings of Berkshire Hathaway and the proceeds will be distributed to charities worldwide. The point is wealthy people hire professional managers to manage their wealth. That is why they like mutual funds. They are professionally managed pools of investments and possess the exact qualities they seek.

3.
Rich people don't pay retail prices.

They buy at wholesale prices. One of the advantages that everyone understands is that when you buy large enough quantities of anything, the price goes down. That is why you see advertisements in stores that say **"buy 2 and get the 3rd one**

free". That's why telecommunication companies give you a discount on a complete package of internet, cell phone and television connections, and to further sweeten their offer, they will probably give you a land line for a few extra dollars. Frequent fliers on airlines get free upgrades. The list goes on and on. Purchasing mutual funds is the same equation. The larger your account, the less expensive the management costs become. The rich know that and they gladly accept the discounted prices.

Just for the record, ***The Tyler Group*** *is hard at work every day looking for ways to reduce the costs of investment management for our clients. We are a fee based, asset based advisory firm and we fully disclose our compensation. It is in both our and our client's interest to deal with the highest quality firms we can identify, who have a proven record of delivering solid investment returns at the lowest cost we can negotiate on your behalf. That is what we do for our clients, whenever the opportunity presents itself. It is also helpful that we represent on behalf of our clients a very large pool of investments. We are completely independent and have no obligation to favor any insurance company, bank or financial firm. Again, size matters, and our chosen suppliers listen carefully. They are eager to earn our clients' business and conduct themselves accordingly. As a result, we have witnessed in the last few years a continuous decline in management costs and all of our clients have benefited.*

4.

The rich like to save taxes.

The wealthy people of most democratic nations pay the largest portion of all income taxes collected. The numbers are significantly greater, and the numbers don't lie, even if the politicians argue otherwise. Politics aside, who doesn't want to save taxes? The wealthy have always been aware that **taxes deferred are taxes saved**. That is what happens when they defer selling their company for many, many years. Even if you end up paying a tax, the longer you can defer it, the less it becomes in real dollars and the more your money is working for you. That is the principle reason Warren Buffett has never wanted to pay a dividend on his Berkshire Hathaway stock. If he defers the tax owing he can compound the value of the stock price. As of Sept 30th, 2014 the Berkshire "A" stock share price was $206,900. It has never had a stock split and it doesn't pay dividends.

Likewise, using the same principle of deferred capital gains, mutual fund organizations are allowed to create **corporate share structures** that achieve the same tax effect as owning shares of companies which defer the gains until they are sold. When they are eventually sold in whole or part, they are taxed as a capital gain, and then only half of the gain is taxable. The other half of the gain is tax free. As you will quickly recognize, that sure beats

paying taxes every year on the interest income from a GIC that you still can't cash in until it matures. The wealthy understand this simple but powerful form of compounding wealth. They readily appreciate the value of using **corporate class mutual funds** that they can use to control their tax bill. It is a simple but elegant method of compounding wealth.

5.

The wealthy understand that wealth is created by patient ownership of great businesses.

Although the ads for lotto tickets would have you believe that wealth is created by luck, and the media would suggest it is created by some clever genius inventing a new technology, the overwhelming portion of business is the daily activity of providing goods and services everyone wants, needs, and is willing to pay for. That is what all the great commercial brands do every day. They

just work at delivering it better, and usually cheaper. That is why more people fly airlines today than ever before. That is why cars last longer and use less fuel per mile than ever before. That is why telecommunication is cheaper, faster and everyone uses it all the time. Knowing this, wealthy people understand that it just makes sense that they own a diversified portfolio of professionally managed busines, in many industries and in many countries of the world. They are not so foolish to "place all their eggs in one basket", and they are wise enough to know that the professionals are better judges of what to own than they themselves.

6.

Wealthy people understand that accumulating and retaining wealth requires patience.

Only foolish people chase after get rich quick schemes and that is why wealthy people never do. That is why they are rich. The wealth they accumulated took many years to assemble, to compound and ultimately to be released to them through some sort of sale or transfer. They are happy to see steady growth and steady income. They realize that trying to outperform some stock index, or pick only investments that go up, is the best way to lose money. They know very well from owning their own business that the true value of a business is seldom reflected in the price someone offers. When that ultimately happens they are willing to accept a fair price. Therefore they don't fret about temporary fluctuations in their investment portfolio, since they have no intention of selling unless it is a fair price. Besides, they always have a portion of their investments in cash-like short term holdings, just in case they need a few extra dollars.

7.

Lastly, wealthy people are seldom "do it your selfers" (DIY).

The businesses they built were always staffed by employees and managers who were very good, and very loyal, at creating great results. They always looked for employees who represented the best talent and rewarded them for results. The businesses prospered and eventually they were able to capture the value the business had created through a sale to other owners, or to their employees and managers, or to a younger generation. If you are interested in a real life example, read my article about Nebraska Furniture Mart and the story of Rose Blumpkin. In fact, Warren Buffett owns inside of Berkshire Hathaway dozens of such businesses, still run by some of the same people who built them from scratch. They are still delivering stellar results to the shareholders of the parent company, Berkshire Hathaway.

Wealthy people focus on enjoying the fruits of their labour and let the professionals manage their financial wealth.

Doing it Wrong

By Rod Tyler, CFP, R. F. P. , CLU

We at the Tyler Group are all great fans of humorous television ads. We are also quite sure you have all seen the television ads from the home improvement company Rona, entitled *"Doing It Wrong"*. If you haven't, I suggest you take a quick peek at a replay of one these great commercials on Youtube.

http://www.youtube.com/watch?v=QfBdKO19mpM

In the spirit of these really entertaining advertisements, we have assembled our own *"Top Ten Financial Planning Tips for Doing It Wrong."*

Here are the first five on the list. Watch for the next issue of *Sound Advice* when we round out our list of the *"Top 10 Planning Tips for "Doing It Wrong".*

Tip #1

Don't have a financial plan.

Financial plans are highly overrated. They are fine for somebody who wants to be absolutely sure he or she can retire, or travel, or send their children to school, or just wants to feel that they have a grip on their finances. Besides, you have to spend as much as 30 minutes gathering up all those papers that your financial planner will want to review when she or he is preparing the financial plan for you. Really, what's the hurry? You can always just wait until you are ready to retire to figure things out. We say "live for today" and just wait and see what happens. Now that mandatory retirement at 65 is no longer permitted, you can always keep on working. That way if you don't have enough to retire, there is a backup plan. You can just go on working. What the heck, just because you are getting a little older, why not have a little drama in your life?

Tip #2

Never use a great advisor.

Using a great financial advisor is highly overrated. All their education and experience is probably available somewhere on the internet. Besides, they might even charge you for preparing a written financial plan. You can save a lot of money on lawyers' fees by writing your own will, so why not do your own financial planning and investing. All you have to do is look for some calculators on the internet and plug in some numbers. Easy, and you can have a lot of fun trying out all those "do it yourself" financial sites. We are sure they have no hidden agendas, like advertiser supported ads or financial software programs for sale. Besides "Live a little, take a chance! Do it yourself." Yes, we know some financial advisors have gone through the rigorous process of becoming fully accredited and recognized as among the best in their field. But why go with proven success. Think of the fun you can have experimenting with the latest investment fads or reading all those books on "*How to Become a Millionaire in 10 easy Steps*". And if it doesn't work out you can always say that you never paid a fee for anything. It was free.

Tip #3

Focus on price, never on quality.

Whenever you are buying something, the most important thing to focus on is the price. Quality isn't important. For example, just check in your closet at all the bargains you discovered at the sidewalk sales. So what if they are not your color or don't fit all that well. Yes, some are a bit out of fashion, but if you just hold on to them long enough, they will come back. Just think how smart you will feel when you realize you are right back in step with the latest fashion trendsetters. Best of all, you will remember what a great bargain that suit was, even if it is a bit too small now. You saved money because you focused on price, not quality. So when you are looking for investments to purchase, always focus on price, never quality. And the same goes for financial advice. Always look for free advice. That way if it doesn't work out you can always say you never paid a fee. It was free.

Tip #4

Watch and listen to lots of TV experts.

The best way to assure your financial success is watch and listen to the television personalities and experts on the business channels. The best part is that there are several channels you can follow virtually 24 hours a day. This means you will be on top of every business and economic report, even if it has nothing to do with your financial future. As a bonus, you can amaze all your friends at the next coffee break or party with all your new found knowledge. Now granted, you still have to make some basic investment decisions, but there is no rush. Just keep watching and listening. Eventually you will know exactly what to do, and when to do it. Don't worry if these experts all seem focused on what is going to happen in the next few hours or days. I am sure they know all the answers. **Yes, we know Warren Buffett doesn't listen to CNN or Bloomberg, but why should he? He already has lots of money. Besides, it's him that they want to interview.** The problem is that Warren is too busy focused on his own investments to be worried about whether the next bit of economic forecasting news will be the sign he is looking for to buy or sell the shares of the businesses he already owns.

Well just in case you want to start watching and listening to all this wisdom, here are the links for some of those sources of riveting entertainment:

www.bloomberg.com
www.bnn.ca
www.cnn.com

Tip #5

Keep all your money in a savings account or GIC.

The most important thing about "investing" your money in savings account or Guaranteed Investment Certificate is that there is no way you can lose any money. Everything is guaranteed. Now we know you may only earn a couple of percent or less in these investments, but the main thing is you can never lose money. Yes we know that the cost of everything you buy is going up, and that you may need to include the interest you earn on your tax return, but you can't lose anything. Well maybe a bit of purchasing power each year, but you know interest rates will eventually rise. Someday. Maybe.

And just remember that you never pay any fees for investing in these guaranteed investments. Better to avoid any fees, even if the growth on other investments can be many times greater and your money is always available if you need the funds for some purpose. Besides, we are sure the bank or credit union offer these investments free. They probably do it for free as a public service so we will do our banking with them. Sure, we know we all are still paying high interest on our car loans or mortgages. But why pay them off quickly. It just feels better to have some money sitting in a low interest rate savings account or GIC than paying off the loans. Besides, why ask if there is a better way to do your banking? Why change a sure thing for a newer idea, even if it does save me money.

Stick with the old way. It is guaranteed.

THE TYLER GROUP Financial Services
2330 McIntyre Street, Regina, SK S4P 2S2
Phone: (306) 525.5250 Toll Free: 1 - (877) 225.5250
Fax: (306) 585.6117 Toll Free Fax: 1 - (877) 255.0122
Email: rtyler@thetylergroup.ca www.thetylergroup.ca

At **THE TYLER GROUP** we accept new clients on a referral basis. If you know a colleague, friend, or family member who could benefit from our advice, please call us.