OSBON
CAPITAL MANAGEMENT

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Learning through crisis
What the financial upheaval teaches us about selecting financial providers

What a summer. Buyouts, bankruptcies, bailouts and blame. The chaos in the financial services industry can leave private investors feeling out of control – worried about the security of their investments and uncertain about the stability of the very firms that manage their portfolios. These concerns are rational, justified and healthy. I encourage all investors to take this opportunity to evaluate the individuals and institutions they rely on for investment advice and management. As we can never know what calamities may lie ahead for the financial industry, this is an ideal time to consider the following questions.

How did we get into this mess?
There's no point in rehashing all of the bad decisions that led to the current crisis, but one lesson is clear: excessive leverage is dangerous. It sounds self-evident, even remedial, at this point, but some of the world's leading financial institutions ignored this simple concept, jeopardizing their businesses, stockholders, employees and clients. For substantial private investors, a fundamental question to ask is: Am I relying on an institution that is vulnerable to industry excesses or questionable practices? Could bad decisions by management threaten the viability of the business? That has just happened to some. Some of the smartest investment people in the business have literally wiped themselves out.

Even while an investor's personal assets may be safe, a significant business disruption could necessitate moving to a new advisor or portfolio manager. As trust, communication and relationship grow slowly over time, sudden changes are understandably discomforting to the individual, and may be detrimental to investment results.

Do interests align?
As a money management client, you want to make sure that all of your investment providers' interests are aligned in your favor. It is easy to say that the client always comes first, but consider the realities of a large organization. A financial advisor or money manager may work in a many-layered hierarchy that ultimately reports to a board of directors, which is in turn responsible to partners or shareholders. And the financial advisor in this framework has personal interests too, including moving up the hierarchy or moving to another company that offers greater opportunity. It is a natural question: Who is the financial advisor really working for?

This issue of aligning interests is most acute in public companies, which have a fundamental duty to promote and enhance shareholders' value. The keys to advancing shareholder value – that is, stock price – are profitability and growth. As such, we have seen Wall Street firms pursue and expand high margin, high leverage, high potential businesses such as credit trading, mortgage packaging and creation of

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proprietary investment products designed to make money for the issuing firms. Private wealth management, by contrast, is not such a high margin business within an investment bank, so its value to the firm is diminished as other lines of business grow more quickly.

Given this scenario of multiple parties, each with its own priorities and goals, who really does come first? And how does the investment professional reconcile the often-conflicting objectives of managers, owners and clients?

Do investments align?
Private clients are right to ask how the owners, operators, and staff of the companies they rely upon invest their own money. SEC reporting and disclosure rules now require fund managers to disclose their interests in their own investments. It is definitely worth the time to explore this important fact. Problems can arise when investment managers don't "eat their own cooking," as Warren Buffett likes to say.

The OCM advantage:
OCM's sole business as an SEC registered investment advisor is index investment management for individuals. OCM borrows no money to operate its business. It is 100% owned by the Osbon family. All Osbon family assets are index-managed by OCM.

Some professionals at investment banks may claim that their interests are aligned with clients' through significant personal stockholdings. But the interests of shareholders and clients are not always the same. Only by living the firm's investment strategy every day and in every way can the investment manager truly understand what clients are experiencing. Moreover, there is valuable insight to be learned by money managers as they personally experience the consequences of their own investment actions. So, ask the question: "How much of your personal money is invested via your firm?"

How does size matter?
Historically, many private investors have been drawn to the largest firms for their sheer size – as though size equated to success, stability and results. That illusion vaporized this year as many of the biggest names in financial services buckled, and several collapsed to the ground.

Clearly size is not a guarantee of success, and in the private client business it can work directly against the investor's interests. The size I am talking about – the employee army – must be regularly fed and cared for. The food for the sales army is commissions. Brokerage salespeople are paid to sell product and must sell product to survive. I know this well, having been a salesperson myself.

In my view, the commission structure in the brokerage business is completely counter to investor interests. It rewards the promotion of products that often benefit the brokerage firm much more than the client. The best salespeople realize this, and may act as a shield against suspect products and ideas. However, it is too much to

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ask salespeople to take your interests into consideration when they are being paid to sell product. Further, continuous pressure to attract new clients can distract salespeople from the needs and interests of existing clients.

To complicate matters even more, after 73 years of regulated separation, all banks are now commercial banks, too, further diluting the importance of private client operations. We risk moving into an era not of 'too big to fail,' but 'too big to operate.'

A private firm for private people

I have never thought there is only one right way to deliver investment advice and portfolio management. The right choice is a matter of personal preference. Nonetheless I encourage all investors to pause amid the ongoing storm and consider the questions described above regarding stability, structure, compensation and alignment of interests.

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Personally, I feel the best way to manage private wealth is with a private boutique firm for private people. I advocate a system where the owner of the business is personally involved in the management of each account and invests all of his or her assets in the same way that client portfolios are invested. This eliminates the client-shareholder-employee dilemma, uniting the interests of all parties. In this model, the advisor goal to succeed is aligned with the adviser's goal in helping the client succeed.

I believe private wealth management is best suited for small, private firms that focus completely on this complex art and science, undistracted by investment banking, product development or other conflicting lines of business. After all, who wants to be one of a thousand or ten thousand clients? This independent, private firm operates with Swiss-like neutrality in a world of endless product choices and limitless information.

I believe in the registered investment advisor model, with its inherent fiduciary responsibility – a legal duty to act in the client's interest. It was with these beliefs in mind that I built Osbon Capital Management (OCM) to manage my family's own assets and those of a select clientele. I like the taste of OCM's cooking.

John Osbon, Managing Partner
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