

Impressions

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10900 NE 8th ST Suite 1600
Bellevue, WA 98004
425.861.0112
dennisgibb@financialprtnr.com

Still Reinventing After all These Years

It Was A Very Good Year

Written by Ervin Drake

*When I was seventeen, it was a very good year.
It was a very good year for small town girls and
soft summer nights.
We'd hide from the light on the village green
when I was seventeen.*

*When I was twenty-one, it was a very good year.
It was a very good year for city
girls who lived up the stairs
With perfume hair that came undone
when I was twenty-one.*

*When I was thirty-five, it was a very good year.
It was a very good year for blue-blooded
girls of independent means.
We'd ride in limousines. Their chauffeurs
would drive when I was thirty-five.*

*But now the days are short, I'm in the
autumn of the year
and now I think of my life as vintage
wine from fine old kegs
From the brim to the dregs. It poured
sweet and clear. It was a very good year*

On Feb 12th of 2004 I moved past a major milestone. That was the anniversary of the day I made my first telephone call as broker for Dean Wit-

ter in Palo Alto, California. I am infected with just enough hubris to believe that you might be interested in some retrospective on 30 years in the trenches.

The Beginning

It was 1973 and I was an Army officer and was about to leave the service when one of the enlisted men at the artillery battery I was assigned to told there was a “guy” waiting to see me. The “guy” was sitting in the waiting room, dark suit, white shirt, striped tie, gleaming black shoes, short hair and that well scrubbed look that screams FBI or Mormon.

He was neither. He was a former Navy officer working as a recruiter for the legendary H. Ross Perot. Perot was known for hiring ex military officers and that was what the “guy” wanted to talk about. Not EDS however, but DuPont Walston a brokerage firm.

For a few years Perot had been purchasing a series of failing brokerages whose names would only be of interest to market historians, but his acquisition spree ended with the purchase of Walston and Co then the second largest brokerage in the United States. According to the recruiter whose name was David, Perot

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was going to hire a cadre of Vietnam combat vets to remake the face of brokerage in the country.

In 1973 there was full scale recession on and there were not a lot of jobs available. There were even fewer for a person with undergraduate degrees in history, sociology, and psychology. My job prospects were further limited by a very small civilian demand for field artillery officers. So with limited choices in front of me I started off on my great adventure.

The Old Days

It really was different in those days. The financial industry was sitting on the edge of a cliff and would be none to gently shoved off by the Securities and Exchange Commission and like Humpty Dumpty it would never be put back together.

It was a clubby world of mostly men and the industry was run by a group of WWII veterans known as the Sand Box Boys.

Commissions on stock trades were fixed, and looking back, obscene. There was not a lot of trading so in the screwy world of brokerage accounting it all worked out. Most banks traded over the counter as did insurance firms and to get registered you had to take two tests the NYSE and the NASD. The NASDAQ was only a few years old as were exchange traded options. Writing covered call options was considered highly speculative. Older market commentators

would talk about dealing in the speculative issues of the day such as Dupont.

In 1973 Congress passed the Employee Retirement Income Security Act (ERISA) and the SEC had mandated that on May 1, 1975 commissions would become negotiable. There was the usual hand wringing that this meant the end of world. The wire houses, there was a clear separation in firms in those days, the institutional firms like Morgan Stanley, Goldman Sachs, Lehman, and First Boston were all partnerships, the wire houses like Merrill, Dean Witter, Bache that were public, figured that if customers wanted lower commissions it was the broker's fault, so any discount in commissions came out of your payout.

This was the first time I had to reinvent myself. I used to just sell to get the customer, now I had to continue that and sell to maintain the customer's perceived value to maintain payouts. In my callow youth I was more concerned with my new wife than I was with the fine points of the business but in retrospect this was the beginning of the value revolution.

There were a few geeks around who went into something called financial planning but we stock jockeys figured that these were the guys who had to go to piano practice while we were playing football. We worked on a numbers basis call 100 get 35 suspects develop 10 prospects and get 2 clients. We were the jacks of all trades and the masters of none and what you learned you learned the hard way by blowing up clients and listening to others, our practice was truly

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that, we practiced on other people's money.

The wire houses were really in the business of gathering assets, read that cash so brokers were really bank tellers. Most of the firms lost money on stock and bond trades so the profitable side was floating client money. To attract the money and keep the brokers occupied and out of bars, the firms created endless products each with its own marketing team and the bet was that you could bring in assets faster than your costs increased. Few of the wire houses had their own mutual funds and all the funds came in one variety, there were no A,B,C,D shares your choice was high apparent loads, or high hidden loads.

There was no variable life and annuities where just becoming available, there were plenty of tax shelters to help with the 70% marginal tax rates of the time but most were just a way of transferring client capital to promoter and broker fees. We were just beginning to work with restricted shares, there were no exchange traded funds, no futures or options on indexes. Commodity trading was for people with nasty stuff on their boots. We all wore ties and suits to work each day and there was no casual Friday. The terminal on your desk was as dumb as most of the brokers and news was delivered by teletype on paper strips.

At the end of 1974 Intel sold for .875 per share, AMD for .125, Dean Witter for \$2. Three years before Avon Products had been worth more than all the steel

companies in the world but was now to be had for around \$6 per share. Joe Granville told his subscribers that the Dow would be rallying back to 575 by year end. The hot product in California was residential real estate and the guy who serviced my water softener owned five houses.

It was all in all a simpler world more naive, more trusting, more ignorant and less service oriented but also more honest. Those who violated the rules were severed from the community. There were fewer rules and we all knew them and the moral code of the guys running the firms was that of an older generation. Offenders were swiftly and severely punished. Strangely there was a sense of accomplishment you worked very hard but there was a sense of belonging and of accomplishment you could see a time when you would be able to be at the top of the heap. We were not ecstatic but in our own way we were happy.

CHANGE

The first of many typhoons hit Wall Street at midnight April 30, 1975. When trading opened the next day all commissions by decree would be negotiated. There was lull in things, commissions came down alright but trading did not pick up because most people did not own stocks or mutual funds, what they owned was through their company pension plans and those were all defined benefit plans over which individuals had no control. So the math was easy lower commissions and payouts, the same retail trading level equals lower take home

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pay. So the solution was to get more customers (hard) or do more trades (easier) guess which one most of us chose?

We as financial professionals largely ignored what Leo Pusateri would recently call the emerging competition we knew about Bache and Reynolds and Merrill but we ignored a fellow named Charles Schwab and in the leafy streets of Palo Alto a firm called Northern California Savings and Loan would invent something called a broker cash account, the first money market fund, and somewhere a group of bankers was creating index linked accounts. A wave of MBAs was hitting the pavement with the concepts of William Sharpe, Robert Merton and others regarding risk and asset pricing in a quiet earthquake. Change was forced on us kicking and screaming because the industry has a great deal of inertia attached to it in the form of on going cost structures so it was not nimble.

About this time, 1977, I began to undergo my second reinvention. I was competing with every other broker sloggng the same old products to people who were being called by every other broker in the world. I was getting more new accounts from Hewlett Packard and Varian people walking into the office than I was from cold calling 8 hours a day. I needed to find an edge. We were not very sophisticated but the clients were getting more so and we had to respond. I became involved in an area called restricted stock which allowed me to bring a unique service to corporate officers.

So quickly my language moved from prewritten scripts to short swing profit rule, tolling the holding period, seller's representation letters, Rule 145, Rule 144, Rule 147 and a myriad of others making me sound like I really knew what I was doing. Strangely enough it worked! I should have learned a valuable lesson but I didn't. Looking back I should have grasped the idea that you have to add value to what you do or you become a commodity and lose the ability to price your product and that your product was not restricted stock or preferred issues or bonds it was the knowledge packed between your ears and the ability to use that information to solve problems.

But as I said I did not learn it, so I ran around getting executives to sell their stock but did not capture the reinvestment of the often considerable proceeds I gave away more than half the product, I looked at people as transactions not as relationships.

It was amazing how long I could ride that one legged horse, it took me from 1977 to 1984 and remains a considerable influence on my business even today. By 1984 everybody who could pick up a pencil was a restricted stock expert so my knowledge was a commodity I had not parleyed it into an unassailable market position. I was also too free with information; a good number of the brokers who were kicking my butt in the monthly production derby were people I trained or convinced to get into restricted stock and even helped to make sales. In a hint of irony one of my Morgan Stanley colleagues Frank Quattrone

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helped me get the biggest restricted stock sale of my life, thanks Frank.

So once again I had to change to survive and grow.

The Second Change

A couple of years after I got involved in restricted stock I migrated from Dean Witter to Morgan Stanley (irony intended) and was working the restricted stock angle still but I was coming to the conclusion that I had to get the other side of the trade. I fell under the orbit of a man named Allen Chosen who at that time was the highest paid person on Wall Street. Allen was chubby, short Jewish fellow who was incredibly smart and informed. He told me that rich people really did not care about making money they just wanted to keep what they had. What they really wanted said Allen was a return that would beat inflation and the chance to make some money when the time was right. He also said that really rich people only wanted to do business with representatives who were arrow straight legally and morally.

A broker working for commissions is a lot like a primitive hunter gatherer. They spend a lot of energy looking for the next kill so they have little time for the niceties of relationship building. It is an exhausting life and many times in my youth I watched older men who no longer had the killer desire to compete try to stay in the business. Some did on street smarts but a lot stopped living and just went into decline. A senior broker without production is like an old dog in a pack; the younger ones take his mates

and then they cast him out to die. The only difference between wild dogs and brokers is (pregnant pause) -there is no difference.

I realized after my conversations with Allen and watching and reading that being the restricted stock guru was just going to make me clerk for others and eventually Morgan would give me the kiss of death, not an outright firing, the gentlemanly Morgan would never do that, they would find a way to make sure that I did not advance and then offer me a job filing second copies of interoffice memos so it would be a Hobson's choice. I needed to do something else.

It was about this time that a great influence came through my life it was brief but great. He was a portfolio manager from Morgan Stanley asset management named George Reiger and he was so smart he said seemingly dumb things but they were only dumb because we could not conceive of the wisdom behind them. George used to say things like 'when meeting with prospective clients make sure you control the agenda' and 'most people in this industry would be challenged to be humble scriveners' or 'why do you want to be in an aggressive mode with your clients?' 'What value to you bring to them?'

George in retrospective was so far in advance of our thinking 1984 that he was truly a revolutionary.

George got me thinking about something I still struggle with. The concept of the soul is generally attributed to religion

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but each of us has a business soul. That soul is developed over time by the sum total of our experiences in the industry. It is a set of beliefs and feelings that determine what we will ultimately do with our practice. If we move too far away from what our soul is telling us we will be uncomfortable and will be less effective than we should be.

I came to realize that I was working against my soul, I was not being paid to make money I was being paid to move money, I was being paid to do the right thing except it was the right thing by me and my employer not necessarily the client. I was not an advocate for my client I was their nemesis because I needed action to survive and that meant trades and trades increase cost and reduce returns.

In 1984 I made a decision that became the tragicomedy of my career. I moved from the staid halls of Mother Morgan to the rough and tumble world of Bear Stearns. It was like night and day, Morgan was the quintessential investment banking firm and Bear was the ultimate trading house. Morgan was WASPy, blue blooded, snooty, and arrogant while Bear was street tough, vulgar and unconcerned of public opinion. They were both alike in one respect. In their own ways they were equally vicious, Morgan apologized before and after stabbing you, Bear just left you to bleed in the street.

My office in San Francisco was like an episode of MASH, full of farcical characters and absurd happenings. Within five minutes of my first day in the office I was offered drugs for sale and within a

week I knew which women in the office were providing more than operational support. Sexual harassment was not a rare occurrence it seemed almost mandatory. We were lead by a great salesman with Napoleon's stature and complexes but none of his brilliance.

It was a comedy in a way until you realized that this was not an asylum these people were selling stocks and bonds to investors who were attempting to accomplish important goals. It was at this point that I realized one of the great truths of the business- trying to accomplish your financial goals by paying commissions is like dating a prostitute and thinking it is love. It was a tragedy because it so embittered me to the business that I almost walked away entirely, I was sickened by what I saw and was open in my criticism which did me no good. I was very unhappy and what I never cognized was that I had already made the decision I would make a few years after joining Bear.

So in July of 1989 I sold my house in the Bay Area loaded my 12 year old and my 8 year old, my wife, two dogs and a cat into minivan and a VW Jetta and starting driving the 1800 miles to Seattle and my next reinvention.

The Buy Side

The biggest change of my career was the movement of one word replacing sell with buy. On the sell side you are moving product and that is your reason to exist and your value to the organization. It is very monolithic world move product, stock or bond offerings, preferreds, junk bonds, options, muni bonds, wealth

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management products whatever but you will be judged in sell side paradise by how much you move.

But on the buy side you are antagonistic to the sellers of products. You are hired by clients to filter out the sell side jabber and to buy the right thing. You are not paid to entice purchase by catching people at vulnerable times or by word games, like "if it comes in blue do you want it?" The payment by fee removes the incentive to move assets around; you get paid to do the right thing, what a concept!

Even though I had been studying the concept of the buy side for a long time I did not get the whole picture correctly. There was a major change underway and I was at the tail end of one and the beginning of another but I did not know it. What was ending was the rush to third party asset management by corporate plans motivated by changes in ERISA. What was beginning was the information revolution whose modality was the internet.

It seems hard to believe that in 1989 accessing the internet was for computer geeks who understood the difference between addressing in SLK and addressing in Sliph, I thought SLK was what followed 500 on a Mercedes. We were still getting piles of annual reports, and quarterly mailed to us each day, brokerage house research was published on dead trees and obscene jokes were faxed. There was a change coming because the IRA and IRA rollover markets had reached critical financial mass and the

401(k) market was really exploding. We had been in a bull market which started in 1982 and with the exception of 1987's bloody week, and the 1991 and 1994 downdrafts would continue to 2000. During the 7 years between 1982 and 1989 most 401 (k) plan were funded by distributions of the company's stock and as the stock rose so did the value of the plan.

Since the only people who were ready for the 401(k) market had been the mutual fund industry the assets rolled in and were the funds grew astoundingly. But what was also happening was that people were being forced into accepting responsibility for their own financial futures and with that a need for more information and resources. There is an old political joke that a conservative is liberal who got a job and paid taxes and that is partly true. When people had to pay fees and commissions on their own they suddenly got very concerned about costs, not concerned enough to look at the buried costs of their mutual funds but concerned enough to force commissions lower and to argue about management fees.

The other great change that was going on was that the message of financial planning was starting to get through. Each person's life is very complex on many levels and with job changes, two income families, self directed retirement plans, non qualified stock options the investment side of people's lives were a real mess. They needed answers not just more products.

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Being on the buy side has been a wonderful experience, it has never been as profitable for me as I imagined it would be, and at times it has been a very rough ride. There have been downsides, the level of civility has fallen and the dislike evidenced by people during the downturns has taken on an ugly cast. The markets and the electronic media as well as index funds have taken people's attention and focused in on performance rather than risk and most people are taking more risk than is justified and when the house of cards falls the resort is to the courts for even the most obvious self inflicted wounds.

The solons in Washington have responded with stricter compliance regimes which make it inevitable that a manager or planner will violate the law.

Finally

I am not the same person I was in 1973 when I went to LA to work for Perot. I weigh more and I have far less hair. I have nurtured a nearly 30 marriage, seen two children from birth to adulthood, I have seen national events which will be the stuff of history. I have been an eyewitness to marginal events in world and financial history. I have seen technologic changes that still make me shake by head in wonder. I have learned a lot about myself in these years, I have learned about depression and elation. I have learned about cynicism and ruthlessness. I have experienced dishonesty on a massive scale. Nothing happens to us without a reason we just need to figure out what the reason is and that is very difficult. I have learned that my true

nature is one of a servant, not a slave, but a servant to others. That is what gives my life meaning, I just wished I had learned it earlier.

I wonder a lot lately whether I am the old dog sitting on the hill waiting for the young stud to come and force me into the wilderness. I wonder if I am like those WWII veterans I knew in 1974 and 1975 just waiting for business death. But then I think not. I still have hope and they had lost theirs. I am cynical but not close-minded. I am still trying to learn and they stopped learning. I do wonder sometimes if the advice I got from a fellow Dean Witter broker at the beginning of my career was correct. His name was Tom Mohrs and he told me that I would never be wildly successful in the brokerage business for two reasons. One was that I was too smart and no one in the end bought smarts they bought what was sold and selling and smart were antithetical, and second that I was not a enough of an a__ _ole.

I still believe that regardless of how mean our public debate has gotten and how polarized our political positions that there are people of good will who need a fair shake from an industry still dominated by self interest and loose moral codes. I believe that there are no absolutes there is only the best answer to the client's problem and that I as a financial advisor need to take responsibility for my decisions. I still believe that being honest is the best business even if time has proven that it is not the most profitable, I believe that no one owes me a living and if my financial condition deteriorates it is not Al Queda's fault or

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George Bush's it is mine .I may not know anything for sure but I do know one thing that if you are going to work in this business you are going to have to reinvent yourself periodically and that will always be the challenge. To do it in a way that honors the past but is right for the future.

Good Luck,

Dennis

Dennis Gibb