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## *“The Street” Still Making it the “Old-Fashioned” Way*

*“In the movie ‘Wall Street’ I play Gordon Gekko,  
a greedy corporate executive who cheated to  
profit while innocent investors lost their savings.  
The movie was fiction, but the problem is real.”  
- Michael Douglas*

By now, you’ve learned I was no perfect angel during my several decades of working in and around Wall Street. I remind myself and people I meet that were it not for the grace of God, I would still be turning the Ten Commandments into the Ten Suggestions. Unfortunately, the street where I first began my profession has gone from bad to worse.

Just before the great bull market began in the early 80s, a well-known brokerage firm employed legendary actor John Houseman as their pitch man, and he ended their commercials with the same line every time, “They make money the old-fashioned way... they eaaaaaarn it.” We used to joke back in my stock brokerage days that they should change the last part to “...they churn it.” (Churning, for those who may not know, is a term used on Wall Street that describes how brokers create transactions simply to create commissions.) Unfortunately for the general public, not only does this reckless, tasteless, insiders’ “joke” remain unknown to everyday hardworking lay people, but far too many on Wall Street continue to make money as they have done for decades – illicitly. What doesn’t help is our modern technology, which allows them to do so without breaking any current laws, a feat that would surely impress some of the best crooks who ever applied their trade through Wall and Broad.

Here’s an example of how technology helps what I have to call “legal theft.” Just last year, we learned that several financial groups spent hundreds of millions of dollars laying fiber optic cables so they could “legally” get in front of stock orders, buying what those orders were about to buy, and then re-selling the securities to those same buyers just a millisecond later at a penny or two per share profit. I think society’s ignorance of these deals (or quite frankly, the assumption that beating others on Wall Street is no crime) is why there was no uprising to demand a change to this method. So, let me put this in layman’s terms and tell me if you still think this practice is ok. What these folks did and continue to do is the same as if they knew you were going shopping, saw your shopping list, bought up everything on your list, and then restocked the shelves with your items at a penny or two higher than what they bought the items for... knowing you were walking in the store, pushing your cart and the carefully-prepared items were guaranteed to be bought.

Another example of the financial industry making money the old-fashioned way was the sub-prime mortgage fiasco which took place less than a decade ago. It was, in my opinion, the greatest financial crisis in our country’s history and a major cause of the recession of 2007-09. Hundreds of

billions of dollars, if not a trillion or more, were lost because financial institutions around the world (led by U.S. firms) sold mortgage-related products that they knew would fail. Furthermore, the financial institutions actually took the other side of the sale.

I truly believe the general public's lack of understanding of these transactions (or should say, transgressions) is the reason that not one high-ranking official of any financial institution was found guilty of these criminal acts. What occurred in the sub-prime mortgage crisis would be like if GM, Ford and Chrysler had sold cars that they *knew* would crash and then bought life insurance on the new owners so when they crashed and died, the car companies could profit twice. Trust me, if this was on the news tonight, the public would be up in arms and the car company executives would be going to jail. Yet, that is what happened, and almost none of the financial execs involved are being held legally accountable.

What would you think of a game where the rules were vague, changed every day without your knowledge, and there was no way to discern how to win? How would it make you feel to find out that not only do most other players have hidden agendas and allegiances, but they also have secret sources of information and much faster playing pieces than you? Given these circumstances, most people would choose not to play. It's too bad, then, that most are already playing this stacked deck one way or another with their finances.

I tell people that when I first became a stockbroker in 1984, the playing board was already tilted against the general public. Now it's even worse. I believe 99 percent of the public has a better chance of hitting the lottery than beating the market trading stocks on their own. Trust me, no matter what some crazy guy with a questionable past (who makes all sorts of noises on his daily TV show and yells "BOO-YAH!") likes to tell you, the game is rigged and only one in 100 people might make a buck. The rest usually lose, and some lose bigger than others.

Talking like this about the financial services industry has not exactly won me Mr. Congeniality. It's put an end to the Christmas party invitations from financial firms, brought me ridicule from many so-called "financial advisers," and my honest revelation is often far too "honest" a viewpoint for the general public to accept. Despite this, I continue to point out that:

- Traditional financial planning is doomed to fail;
- The vast majority of money managers fall short in performance;
- "Market timing" is nothing more than a cuckoo clock;
- Most in wealth management end up moving your wealth one way and theirs another;
- Cash flow—not net worth—is king.

If you were in need of surgery to save your life, would you allow a doctor to operate on you who failed 80 percent of the time compared to his or her peers? If you found yourself in legal trouble, would you want an attorney who failed to achieve what 80 percent of other attorneys managed to obtain for their clients? If you said yes, stop reading now. If you said no, I'll share another tidbit: 80 percent of professional money managers failed to match the performance of simply putting money in a basic, low cost index fund. Odds are good that your investment funds are being managed by the 80 percent—*not* the 20 percent. Before you run to find one of the 20-percenters, know that in all likelihood their "winning streak" will soon end like mine did, and they will join the 80-percenters going forward.

Dislike me yet?

Do you know how people of wealth obtained it? Most got it one of these three ways:

- Inheritance,
- Business ownership, or
- Buying and selling commercial real estate.

Despite the stock market being the investment of choice for the majority of people, I have discovered that its role in creating wealth tends to be limited to:

- Investors who get to be insiders at the earliest part of the food chain;
- Members of senior management who are granted stock options at much lower prices than you can purchase shares for;
- Financial sales people who sell financial products.

Still with me? If I haven't lost you yet, this next part could do the trick.

Wall Street has spent tens of billions of dollars creating an image of success when in fact, the vast majority of investors fall way short of their hopes and dreams. As I detailed in Chapter 12, traditional financial planning—a practice that today may come with lots of computer-generated graphics, statistics and bells and whistles—is destined to fail or fall far short of the intended goals. It's not because of dishonesty or a lack of skills; I'm certain that the vast majority of financial advisors in the U.S. get up each morning and hope to do an honest day's worth of work. Unfortunately, the very disclaimers given to their clients have the candid answers to their possibilities, albeit in legal mumbo jumbo that most don't comprehend or choose to ignore. It's the part that includes the phrase "past performance is no assurance of future results..." What it amounts to is something it took me 30 years to conclude: no one among us knows the future and almost all will not reach the theoretical returns built into the plan.

The straws that break the camel's back as to why so many investors don't come close to achieving their financial goals are these three commonalities found within the financial services industry:

1. The bulk of a financial advisor's education is geared toward getting his or her license. After that, much of the time is spent on product and sales training;
2. Hubris and arrogance of the client and/or the advisor (I'm guilty!) lead to decisions based on emotions versus academics and/or a proven process;
3. People buy because of greed and sell due to fear.

Show me an investor who has not obtained the financial success that he or she thought was once likely and I'll show you that he or she:

- Was way too dependent on just equities to increase wealth;
- Had a financial plan that depended on factors no one can consistently and correctly forecast over time;
- Had an advisor who was far better trained in sales than how money really works.

Over the bulk of my career, I travelled around the world speaking at investment conferences. It didn't take long before I concluded one critical factor about the lion's share of all the attendees: most came not to learn something new or different, but rather just to get confirmation of what they already believed. This phenomenon plays right into the hands of many who work in the financial

world because when it comes to advisors, there are only two types:

1. Those who say what they think, and
2. Those who say what they think you want to hear... and it sells.

I'm here to say what I think. In an industry where you're truly only as good as your last call, falling on my face the last few times was truly sobering. With ego and pocketbook deflated, I finally practice what my financial mentor has preached to me for nearly 15 years. If you come away with just one realization after reading this book, I hope it is this: *Cash flow is for YOU; net worth is what you leave for SOMEONE ELSE.*

Got that? *Cash flow* (as described in chapter 12) is what you use now and will continue to use in retirement to pay your bills, go out to dinner, pay for health care and generally support your lifestyle. Cash flow is your paycheck. *Net worth*, on the other hand, is a number that reflects your overall wealth. Add up the value of all your investments and all your stuff, and that number equals your net worth. But the holdings that make up that number are often tied up in assets or investments such as stocks, bonds, real estate, or gold, and they are not liquid. You can't use shares of stocks to pay the mortgage. First, you have to liquidate those shares at which time your financial services professional gets a fee, then you pay a hefty tax on the capital gain between what the share is worth now and what it was worth when you first acquired it, and finally you can use the proceeds of that transaction to pay your bills. So, after your advisor and Uncle Sam get their cut, you can create a lifestyle with the rest...assuming that it's worth more today than when you bought it, and events of the past have proven that increase is certainly not anything that can be guaranteed.

Show me a business that failed and I'll almost certainly show you a business that lacked proper cash flow. That is not dissimilar to you running the business of your life in retirement—poor cash flow will make your retirement plan a failure. Yet, the financial world has brain-washed investors into thinking net worth is the key to financial success. How many times have you seen that commercial of a person carrying their “retirement number”? You know... that mythical net-worth figure that's supposed to assure a comfortable post-career lifestyle? It's not the failure to reach the number that often causes the plan to flop as much as it is a misguided obsession with net worth as the scorecard of wealth.

Though net worth may be a valuable yardstick for some things, in retirement what really matters are cash flow and after-tax income. Yet, almost all typical financial plans use reverse engineering that is only intended to preserve principal net worth while living off of interest. The reverse engineering begins with how much income a person thinks he or she will need, and then backs out “the number.” If a person wants to retire on \$125,000 a year (which is a total guess, by the way), this approach assumes one needs a net worth of roughly \$2.5 million to avoid dipping into principal. That's based on the formula adopted industry-wide which assumes a retirement portfolio will yield about four to five percent per year in income without diminishing principal.

Think about that for a moment. They're *counting* on four to five percent gain year after year after year. Raise your hand if, like me, you've taken such heavy losses some years that you'd be happy that some of your investments were worth only five percent less than when you bought them? Letting your lifestyle in retirement rest on the assumption that your portfolio will yield four or five percent per year is foolhardy, in my opinion.

The investment industry promotes this magic number notion because it's in the business of

accumulating assets to manage. Financial institutions are merely intermediaries; they just connect people and businesses with money and get paid very well as middlemen. The more they connect investors with investments, the more money they make. There is a disincentive to showing clients how they may be able to spend some of their principal and still achieve their goals.

They use the fear of outliving one's assets to continue this pattern that benefits them over their clients. In addition to using fear as a motivation, the financial services industry counts on the fact that the average investor is a creature of habit. Despite the likelihood that you may now conclude the financial services industry isn't all it's cracked up to be, their constant barrage of marketing combined with your human nature to default to what makes you comfortable (along with a dose of procrastination), are strong forces that many can't overcome. Like any other bad habit, many people just do what they've always done.

Instead of staying on that hamster wheel, I suggest focusing on a process to build and protect wealth with efficiency at the core, which can lead to a better quality of life. Use an academic approach to asset management and protection, not an emotional one based upon what some product may or may not have done in the past.

It may have taken three decades but with the help of my financial mentor, Frank Congilose, I finally came to the realization that any good financial advisor must demonstrate to his or her clients how critical their lives require financial balance to achieve personal fulfillment. *True wealth management demands improving a client's quality of life, and cash flow will determine that quality—not net worth.* Many people boast substantial net worth but have poor cash flow and thus feel poor. What is the benefit of having \$2.5 million worth of anything if you still can't pay your bills?

Since the industry and much of its sales force focus mainly on the sale of products, this kind of education fails miserably in teaching its clientele how to reduce and eliminate many of the wealth-eroding factors faced in today's world. If financial advisors focused on a process that demonstrates efficiency, cost recovery, asset protection, asset utilization and then wealth building, the advisors and their clients would be much better off. I believe that real wealth is not achieved by exotic financial products or complicated strategies, but instead it is derived from making the most of the opportunities that are often overlooked and underutilized.

If you made it this far, let me congratulate you. I suspect only a small minority of people who began reading this book have read through up until now. That's okay. I've come to accept the fact that only a few will really appreciate hearing the brutal truth, while the rest will still be prime targets of an industry that has spent tens of billions of dollars marketing an ungodly and unethical belief of the lie that more money equals more happiness.

Yes sir, it's still the old-fashioned way.