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B-Ds brace for lower trading volumes

By Bruce Kelly

In the wake of last week's fear-inducing market tumult, small and midsize broker-dealers are bracing for reduced trading volumes in the months ahead, which will squeeze already tight margins and could push some of them out of business.

"It will flat-line," said Mark Goldwasser, chief executive of National Holdings Corp., the holding company for two independent broker-dealers.

"It takes about a month or two, and volumes will be reduced. These are the most extraordinary markets I've ever seen, and I've been doing this for 30 years," Mr. Goldwasser said.

"This is not good for brokers," said Timothy Hurley, managing director at Bentley Associates LP, a boutique investment bank. "Clients tend not to do anything when they're transfixed with fear."

Broker-dealers have faced a number of pressures during the past few years, including investor anxiety about the stock market.

Firms have been going out of business steadily. Since 2006, the number of firms registered with the Financial Industry Regulatory Authority Inc. has declined by 10%, standing at 4,525 last month.

"I don't see a wipeout of broker-dealers [from the market drop], but it might accelerate a couple that were going to go out anyway," said David Alsup, director of business development for The Compliance Department Inc., which tracks broker-dealer openings and closings.

"This is not a 60 to 80 BDW," he said referring to the "broker-dealer withdrawal" form that firms file with Finra when shutting down.

"Most broker-dealers are prepared for this," Mr. Alsup said. "Over the past years, they've stripped themselves down to the bone. They're quite lean at this point.

"It's not a free fall of firms going out of business, and maybe we'll stabilize for a while," Mr. Alsup said. "But if the market caves in, that's a different story."

OTHER PROBLEMS

A declining market isn't the only problem that broker-dealers face, according to some executives.

They pointed to the crush of proposed regulation from Finra this summer, such as a 400-page advertising rule and a 420-page supervision rule, along with a new suitability rule that will take effect this fall, as more immediately problematic and stressful for firms than the market volatility.

Federal Reserve chairman Ben S. Bernanke's decision Tuesday to keep interest rates exceptionally low through mid-2013 is another blow to potential profits.

Historically, low interest rates have decimated broker-

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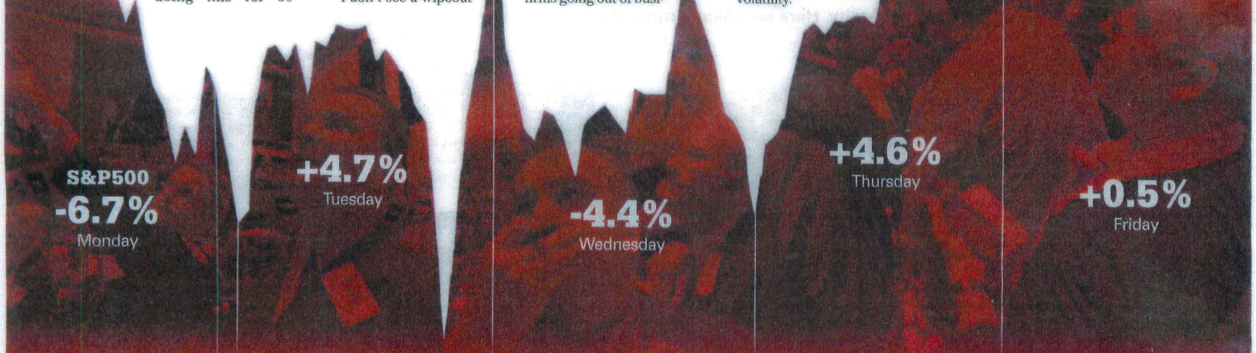

Rattled investors seek safety of money markets

By Andrew Osterland

Seeking a safe haven from gyrating markets last week, investors cashed in some chips and placed them in money market funds.

"We're seeing so much volatility that people are stepping to the sidelines,' said Matthew Lemieux, an analyst with the Lipper unit of ThomsonReuters.

In the week ended Aug 10, investors pulled $14.4 billion out of equity mutual funds and exchange-traded funds, according to Lipper data.

They also yanked $6.9 billion from taxable bond funds and ETFs —the largest weekly outflow from bond funds since the week of Oct. 15, 2008, according to Lipper.

High-yield bond funds suffered the biggest drawdowns, with investors pulling out $3.4 billion, or 2.8% of total assets in the sector.

Investors seem to be putting most of money into money market funds, which took in $47.5 billion for the week.

"I expect we'll continue seeing more outflows from both equity and bond funds until this volatility decreases," said Mr. Lemieux.

Those in need of investment income now have some difficult decisions to make, said Brian Rehling, chief fixed-income strategist at Wells Fargo Advisors LLC.

He said investors basically have two choices: take on more credit risk or more interest rate risk.

Mr. Rehling suggests a little of both.

He is recommending lower allocations to Treasury bonds and TIPS because "the yields just don't make sense" and bigger allocations to assets such as municipal bonds, preferred securities, dividend-paying stocks and some high-yield debt — after the markets calm down.

Although the weak economy does not

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'Go-anywhere' funds deliver as promised

By Dan Jamieson

If last week's volatility was a test, go-anywhere funds passed.

Classified by Morningstar Inc. as "world allocation" funds, go-anywhere funds have been growing in popularity as a core holding, having the flexibility to allocate globally among stocks, bonds, cash, gold and other asset classes intended to hedge risk.

From July 1 through Aug. 9, the world allocation category declined by 5.66% while the S&P 500 was down 11.06%, according to Morningstar. Year-to-date through Aug. 9, the category was off 2.82%, compared with a 5.7% loss for the S&P 500.

Indeed, bad times have driven new entries in the category. Of the 123 funds classified as world allocation portfolios, 30 were launched last year and 28 this year.

"It's a great sell: Avoid the bad times, participate in good times," said Michael Herbst, associate director of fund analysis at Morningstar.

On the flip side, the funds were up 10.58% last year, compared with a 15.06% gain for the S&P 500. But that is just fine with financial advisers who use the products.

"We know we're not going to get the full upside," said Stephen Blum, president of Strategic Wealth Planning, which has $75 million under discretionary management.

THE FINE PRINT

Advisers need to make sure they know what their clients own, Mr. Herbst said.

"This is one of those categories where the range of strategies is so wide, people think they have one thing, but actually have another," he said.

Some go-anywhere funds mimic a standard 60/40 mix of stocks and bonds that "you could get a lot cheaper" in other ways, said Robert Kresek managing partner at

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"Holding companies are holding significantly more cash — double or triple the amounts they had in the past — to cover their debts if they are incapable of borrowing. Capital levels are substantially higher than in 2008 and that gives the companies the ability to weather any

since the darkest days of the financial crisis: The KBW Insurance Index closed last Thursday at 103.49, up 134% from its all-time low of 44.16 on March 6, 2009.

To be sure, the index tumbled along with other financial stocks Aug. 8, the first trading day after Standard & Poor's unprecedented downgrade of the nation's credit rating — falling by 9.83% to close at 96.52. The broader Dow Jones Industrial Average fell by 634.76 points, or 5.5%, to end at 10,809.85.

and Symetra Financial Corp.

In its second-quarter conference call two weeks ago, American International Group Inc. said it had recently invested money into "various asset classes," earning an average yield between 4.5% and 6%.

Mark Herr, a spokesman for AIG, last week declined to specify whether those assets included asset-backed securities.

"There has been gradual re-risking of portfolios since 2010," said David [illegible], principal at Alirt

Moody's Investors Service, concurred.

"We're aware that there are some companies that have dabbled in beaten-up [residential mortgage-backed securities], trying to buy securities at a nice discount," he said.

Another sign of that additional risk can be found in insurers' bond portfolios. At the end of last year, 64.2% of those portfolios were invested in triple, double or single A-rated investments, down from 66.1%

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million in assets. They are a little more manic than usual, but most change their mind before they send that e-mail, and nobody has asked me to go to 25% cash yet."

Although the sudden stock market plunge has taken a toll on pre-retirees' portfolios, advisers say that the 2008-09 decline serves as a kind of shock inoculation. Over the past three years, advisers have recommended a more conservative investing approach and have kept in closer touch with clients, result-

Of the calls she has gotten, "most are from clients who are less sophisticated, rather than baby boomers," she said.

ECONOMIC WORRIES

Older clients aren't as worried about their personal portfolios this time around, Ms. Curtis said.

"They are not happy about it, by any means, but instead of their personal portfolios, they are more worried about the general economy and where things are going —

uation and that of 2008, which triggered by worldwide fears liquidity freeze and a banking down. This time, the banking tem is awash with liquidity while the economy may be hea into recession, U.S. companie reporting strong earnings.

"In 2008, we were talking a the lights going out," Mr. Mu said. "People could look around see the problems," such as income neighbors who held

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What investors are saying

InvestmentNews reporter Liz Skinner interviewed individual investors to find out how they are coping with the market's volatility. Here are their comments.

Rajat Chaudhuri, 44

Denver
Painter; used to work for a software company
He and his wife, Dr. Christy Chaudhuri, have about $250,000 invested in the market.

"I don't know what the market reflects right now. It's definitely concerning that it's so volatile, and we've seen that a couple times now. I think the economy worries me more than the stock market, which, in this disconnected era, you become immune to or less shocked by. If the economy goes down, that's much more of a concern."

Of his financial adviser, Ajay Kaisth of KAI Advisors, Mr. Chaudhuri said: "I know he's going to treat my money as his. We've had other financial people help us, but there's never been the amazing honesty and disclosure. This week, I spoke to him for 30 minutes and received two nice newsletters about what is going on, and he told me not to panic. This is why having someone who knows what's going on helps. Just having him keeps me from panicking."

Skip Harrington, 66

Farmington, Conn.
Retired; used to work in the insurance industry
Has about $1 million invested in the market

"People are losing their minds for no particular reason. The [Standard & Poor's U.S. government credit] downgrade is no big deal. It's not the end of the world, and we've been through a heck of a lot worse things than that.

I am recently retired, and my wife [will] retire in the next two years. From a timing standpoint, we're at the point of being concerned about everything because we want [our] 401(k) and investments to be there.

But I haven't given up on the stock market. I think it's healthy. To pull out of it would make no sense, and it sort of makes sense to buy.

I almost think I'm going to stop watching the news. I'm not down on the stock market or the economy. The U.S. economy is horrible, but a lot has to do with housing that hasn't cleared up.

We moved to [our] current adviser [Susan S. Spraker of Spraker Wealth Management Inc.] in the spring of 2008 when everything had gone to pot and our adviser wasn't doing anything. We weren't getting any kind of service from him. [Ms. Spraker] has taken a reasonable long view. She's buying things when other people are panicking or being irrational."

Robert Lauterborn, 75

Chapel Hill, N.C.
Runs an international consulting business
Has a "couple of million" dollars invested in the market

"[The volatility] doesn't bother me for a couple reasons. One is my [financial adviser] Mike Palmer [principal at The Trust Co. of the South]. I found him 10 years ago, and he put my life in order. He is a calming influence and is totally honest. He even takes care of my children's financial questions sometimes. He rationalized my investments and built a plan that makes sense. We're not doing short-term trading. We have a balance of investments that are rational for my age. He also made sure I had a couple of years' worth of cash so I don't have to sell anything in times like this. I tell him he really sells a good night's sleep.

I am politically conservative. Politically, we have persuaded a lot of people they don't have to take responsibility for themselves and we have bailed them [out]."

Nitin Manchanda, 44

Seattle
Helps large corporations reduce energy consumption
Has about $500,000 invested in the market

"The silver lining is that I feel better having been through a similar situation a couple years ago. It's trained me for this one.

Regarding the economy, I am reconciled to the fact we'll have high unemployment and low growth for the next decade. [That] realization made me a little less frazzled by all this."

His financial adviser has "been regularly sending updates through e-mail. They have been reassuring but also what you'd expect from a financial adviser."

John Sawczak, 67

Cleveland
Professional investor; in effect retired but teaches a class on technical analysis
Declined to disclose how much he has invested in the market

"I saw [the downturn] coming, and I made a lot of money shorting with ETFs," such as those targeting the Russell 2000, the Nasdaq Composite and oil.

"Whether we head into another recession or not depends on whether there is a QE3. That would re-inflate the market and provide excess liquidity that would find itself into the financial markets.

The solution is 15 to 20 years of debt reduction, not government debt reduction but the $34 trillion in private debt. At $14 trillion, government debt is just the pimple on the backside of the world."

Kent Messamore, 71

Bedford, N.H.
Retired; worked in the computer industry for 44 years
Had about $750,000 invested in the market at the end of June

"I have been somewhat worried about [the market] in the past. [I am a] little more comfortable now after hearing what the [Federal Reserve] said Tuesday, if you can trust the Fed. I like that they said they will keep interest rates low until mid-2013. I've been very concerned about interest rates going up.

The stock market is reacting to the disastrous news we've had over the last couple weeks because Washington, D.C., looks like a bunch of idiots. I am more on the side of the Tea Party. I think we have a bunch of fools in Washington running the country and that includes the president and both houses of Congress. It doesn't surprise me that the stock market is going up and down all over the place.

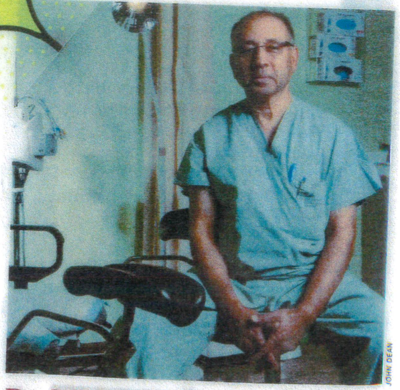
I think the economy of the U.S. is doing better than anyone thinks.

I liked Rep. Paul Ryan [R-Wis.]'s proposal for a 10-year budget. It made a great deal of sense, particularly the tax proposal. Our tax rates are way too high."

Tyler Watson, 32

Baton Rouge, La.
Building contractor
Has less than 10% of his investments in the markets; invests most in real estate

"I'm not looking to take money out; I'm confident in what we' in. I favor opportunistic thinking, that there will be a positive outcome, that there will be an opportunity to make money. But I'm de nitely concerned. Previously, I just checked my monthly statement. Now I'm checking on my account every couple of days."



JOHN DEAN

Dr. Nikhil Sheth, 59

Baltimore
Urologist at Harbor Hospital
Has about $3.5 million to $4 million invested in the market

"I'm more concerned with the weak U.S. economy than about the daily volatility of the stock market. I am not near retirement, so I have a better time frame and I'm hoping to ride things out.

The biggest disappointment is with the political landscape of the country right now. There's a widening gap of what is achievable politically and what does get achieved."