The Biggest Personal Finance Story of the Past 30 Years (Part 3)

Category : Are Your Best Interests the Same as the Financial Services Industry?

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There is no reason to believe that industry self-regulation or governmental regulation will ever fix these problems. Only those individuals who become wise enough to be proactive and seek out lower cost financial products will stop getting fleeced. The vast majority or individuals will just keep on paying excessive costs to the financial industry, while they receive inadequate value in return. The financial industry will continue to flood the market with endless combinations of new and "innovative" financial products and services and tell individuals that they are doing them a favor. Individuals will grow increasingly befuddled, and the historical trend indicates that most people will keep paying too much. (See these related articles on *The Skilled Investor* website: The heavy burden of recurring investment fees and The investment industry is not your investment partner)When it comes to personal finance, only those who make money from individuals will have the motivation to approach individuals to sell to them. These financial sales people have a strong incentive to spin yarns about how they will help people to do better than they otherwise would do. The financial industry will keep making promises without making any guarantees. When confused individuals pay too much for financial services, they cannot help but end up with less than they could have had, if they had bought lower cost financial products.You might ask, "How can you look at Figure 4 of the Siegel and Schwartz paper and say all this?" Well, it is not that difficult. First, let us take a look at what it means for Financials to be almost 21% of S&P 500 market capitalization and twice the market capitalization of the Energy sector.The S&P 500 Index currently represents about 75% of total U.S. public equity securities market capitalization starting with the largest companies and working downward to assemble a list has 500 firms. The inclusion of a firm in the index is not based solely on market capitalization, but it is a major part of the Standard and Poors index methodology. Use this link to Standard & Poors, if you want more information about the management of this index.While Standard and Poors has published the S&P index since 1923, it was not until 1957 that the index first had 500 equities. Figure 4 of the Siegel and Schwartz paper indicates that financial companies were a trivial part of the S&P 500 index until 1976. Siegel and Schwartz suggest that part of the reason was that "The only financial stocks in the index in 1957 were consumer finance companies, such as Household International, Beneficial Corp, and CIT Financial. Banks were not added to the Index until 1976. One of the reasons given for the early exclusion of bank stocks was that most banks were trading on the over-the-counter exchange (which became Nasdaq in 1971) and timely price data were not available." (See footnote 8 on page 4)In 1976, 40 financial services firms were added, when the total Financial sector share of S&P500 index capitalization was only about 6%. In the three decades since 1976, the Financial sector's market capitalization percentage growth has been dramatic and relatively steady. In terms of the Financial sector's relative share, the dot com bubble temporarily depressed the Financial sector's overall market share, but Financials' share has snapped back to its upward trend line following the collapse of the bubble. Furthermore, while widespread human greed and Alan Greenspan's "irrational exuberance" explain much of the dot com bubble, the financial sector was also highly complicit in the development of the technology equities bubble. You may not need a reminder, but do you remember:

a) when individuals were being exhorted to trade, trade, and day trade to get rich and to own their own islands? b) when all those "objective" Wall Street analysts just somehow could not find it in themselves to issue a "Sell" rating on any stock, until corporate lawyers were walking up courthouse steps to file bankruptcy papers? (Their objectivity was, of course, protected internally from undue influence by the investment banking side of the firm by "Chinese Walls," which now seem akin to the impermeable walls on the Southern Border of the U.S.) c) when venture capitalists and investment bankers could not resist selling IPO after IPO for companies with huge negative cash burn rates, such as the brilliance of 4th venture funded company with a business plan to sell 50 lb bags of dog food over the Internet? (Meanwhile, investment bankers were lining up the next IPO by letting company executives form other in at the IPO price, when individuals had to by after IPO prices jumped?d) when overly simplistic and poorly designed 4 star and 5 star mutual fund ratings gave investors the impression that growth stock and tech stock funds were just not very risky? (See these articles on *The Skilled Investor* website: The quality of the old mutual fund Morningstar Ratings prior to mid-2002 and Rating Services - Morningstar)

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