BCWM
PROVIDING PEACE OF MIND

Something for Nothing

Back in the day, stock brokerage firms could charge an arm and a leg when helping you purchase or sell shares of stock.

And they did. Sometimes more.

It used to be if you purchased 200 shares of a $50 stock ($10,000 trade), the brokerage firm might charge as much as $150 or $200. And no matter the size of the trade, the minimum commission was never lower than $50.

The good ol' days weren't always so good.

To be fair, the brokerage firm would claim that those ridiculously high commissions did more than cover the cost of purchasing securities — they also paid for the professional advice being delivered by the broker.

Turns out the advice coming from most brokers was suspect, specious, or completely worthless — and every now and then, criminal.

In the 1970s Charles Schwab came up with the idea that investors shouldn't have to pay such an outrageous fee for something that costs very little to accomplish. And investors definitely shouldn't have to pay *extra* for specious advice.

Schwab created a "discount brokerage" firm for the investor who didn't want any advice. It became the first, the largest, and the best-known broker for discount trading, although many copycats quickly followed in the '80s and '90s.

As more competitors entered the arena of discount trading, the cost of transacting a trade began to decline even more.

It wasn't long before the "maximum" commission on *any* size trade was $19.95. Then it fell to $9.95. A couple years ago, the industry decided $4.95 was a fair price for helping you trade your stock, no matter how many shares.

Which brings us to today . . . October, 2019. The Charles Schwab Corporation announced this month that it will begin processing stock transactions for FREE. That's right. FREE . . . ZERO . . . NADA.

Not that free is much different than $4.95, but still, FREE? Who does anything for free?

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(It's interesting how, during a 40-year period where the price of most things have increased, the cost of trading securities has plummeted. To be sure, many products have delivered more at a smaller cost over the past 35 years. For example, the first "car phone" cost almost $4,000, and all it did was make phone calls! Now your cell phone costs much less and it does much more than make phone calls.

But few products in the past 40 years have dropped to a price of NADA!

As competitive as this landscape has become, we are curious if any of the discount brokerage firms might actually start paying us for trading stocks.)

We can hear the wheels turning in your head. What's the catch, right? Nobody gets something for nothing. How can Schwab (and Fidelity and TD Ameritrade and E-Trade . . .) stay in business if they are doing the trades for free?

It turns out that these discount trading firms figured out other ways to make money without charging commissions on trades.

One was to enter the advisory business, hiring wealth advisors to meet with clients and charge for that service. (See above regarding specious advice.)

Another was to create their own mutual funds and ETFs (Exchange Traded Funds) that charge a management fee (a fee you never really see or feel, but trust us, it's there). Then all they have to do is steer you to invest in those funds. And it's a double whammy to 1) pay the advisor a fee for guidance and 2) be steered into the broker's funds.

Those two methods are pretty straightforward and what you might expect. Well, maybe.

But there is a third way that these firms make money and it's definitely *not* what you would expect. They use *your* money to make money. That's right, *YOUR* money.

What most people do not know is that the lion's share of revenues made by discount brokerage firms come from interest they earn using *your* cash — interest that should be credited to you but somehow isn't.

When you sell a stock through a discount broker, you may naively think the cash from that sale automatically goes into a money-market fund, where you earn interest. Not necessarily so. And believe it or not, the discount brokerage firm takes *all* the cash in *all* the clients' accounts every night (literally millions of dollars) and invests it to earn interest for the broker, NOT FOR YOU!

Unsurprisingly, this creates incentives for them to encourage investors to hoard cash, which seems to us to be just a minor conflict of interest.

Another new service offered by the discount brokers is called a "robo-advisor" where you fill out a survey and then a computer manages your investments — for "free."

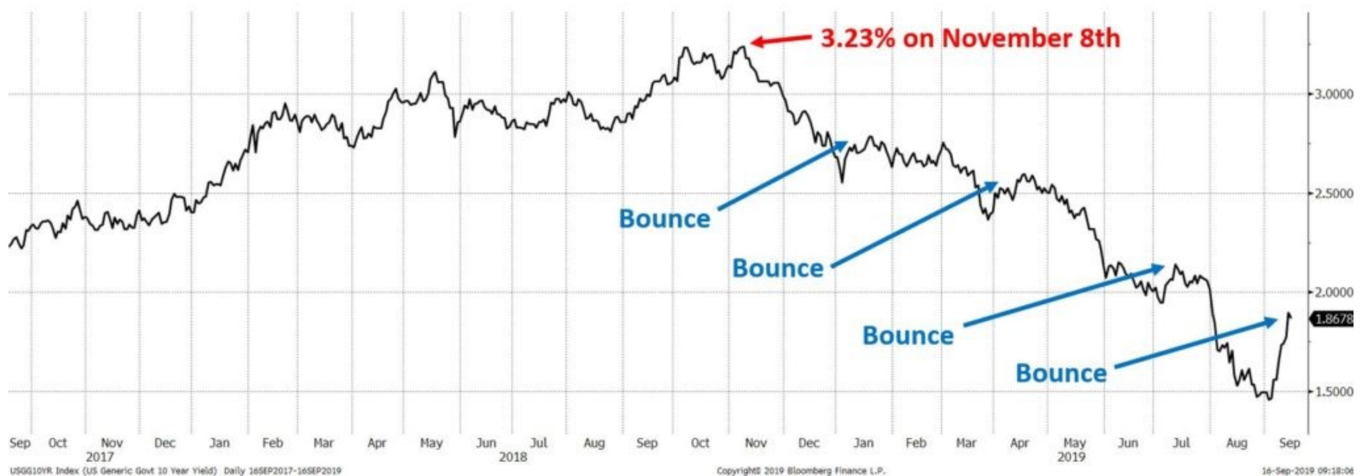
And whad'ya know . . . that computer just might decide that you should hold a rather sizeable percentage of your portfolio in cash. Again, you earn nothing and the brokerage firm earns interest on *your* cash.

The practices listed above are not exclusive to any one discount broker. All of them are guilty. The burden lies on the investor, or their investment manager, to ensure that they are in the right investments and that the investments are working for the client and *only* the client.

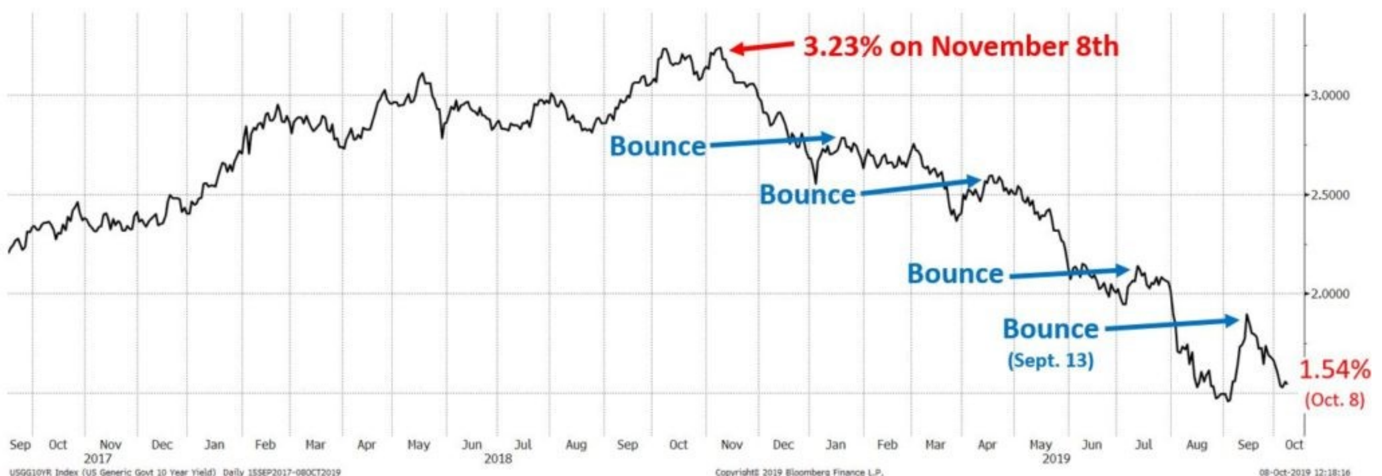
When Schwab stopped sweeping cash into money-market funds, we at BCWM adjusted our back-office operations to make sure funds are always swept into money-market funds and not left in cash.

Don't get us wrong: zero-commission trades is a positive change! It's a big win for investors. But we don't forget that everything comes at a cost. Whatever the fallout from this latest development, we at BCWM will make certain that, for our clients, it has a positive net effect.

As our readers know, we have been predicting lower interest rates for a number of years. After another "bounce" up in rates last month, we showed you the graph below:



One month later, that graph looks like this . . .



The interest rate on the 10-year U.S. Treasury rapidly increased to 1.90%, but has since trended back down to 1.54%, not far from its all-time low.

We continue to see this as the norm going forward, and the economic data released last week further supports this conclusion.

For starters, U.S. manufacturing data was the weakest in 10 years. Manufacturers continue to struggle with uncertainty around U.S. trade policy. It should come as no surprise that firms dependent on global supply chains are having problems in the midst of a “trade war.”

At the end of October, we’ll find out how much (or little) the economy grew in the 3rd quarter. It is expected to be less than 2%, perhaps one of the lowest growth rates of the last several years.

Low growth tends to bring low inflation, which, in turn, leads to lower interest rates.

It’s been a good stock market run since the panic bottom of March 6, 2009. And if you had 100% of your investments in the S&P 500, you almost certainly outperformed pretty much any other portfolio. It’s always easy to look back and see where you “shoulda” invested your money.

But let it be known that for the past 12 months ending on the day we are writing this, the bond market (as measured by the Bloomberg Barclays U.S. Aggregate Bond Index) kicked the stock market’s butt, earning over 11% versus a measly 4% by the S&P 500.

Just sayin’.

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