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# PERSPECTIVES

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June 2015

## Incentives

Charlie Munger, Vice-Chairman of Berkshire Hathaway and described by Warren Buffet as “my partner,” said “If the incentives are wrong, the behavior will be wrong. I guarantee it.” For most participants in the financial services industry, Mr. Munger is spot on.

Survey after survey has shown there has been a deterioration of trust of the investment industry by the public. CFA Institute president Paul Smith said “Society has fallen out of love with the investment industry.” We are not sure that society was ever “in love with” the profession, but many of the actions of so-called financial advisors have put a black cloud over the field.

We are very proud of our record of trust and commitment to “client first” values. One of the major tenets of our core values is that we have no conflicts of interest with our clients. This is unlike many other financial professionals, where the incentives are wrong and therefore as Charlie Munger notes, the behavior is wrong.

Possibly number one on the list of bad products is the variable annuity. Who likes variable annuities? The people who sell them. They are likely the only ones to benefit. The commissions are outrageous (up to 8%), the disclosures are poor and the salespeople and advertising prey on retirement fears and the chance of outliving retirement savings.

Many mutual funds also have incentives that hurt the investor. Many funds assess “sales charges” in order to buy the fund. In essence, the purchaser of the fund is paying the seller of the fund to place him in the investment. Why do some mutual funds do this? Feel free to draw your own conclusions, but if

one mutual fund pays a commission and another does not, which fund is the advisor more likely to use? There are thousands of mutual funds in the marketplace and sales charges are a way to reward an advisor for placing clients in the fund. We have never been paid a commission for placing client money in a mutual fund or ETF. Other conflicts include investment banks with “buy” recommendations on stocks of companies for which they provide investment banking services.

Additionally, many investment firms accept “soft dollars.” Soft dollars are benefits provided to an asset manager by a broker-dealer as a result of commissions generated by financial transactions executed by the broker-dealer. We have never accepted soft dollars. We always look for best price and execution when it comes to making trades. We don’t benefit one cent from directing brokerage to a certain broker, nor do we benefit from any commission that is charged by the broker.

The point of highlighting some of the conflicts that exist in the money management industry is not to claim some ethical high ground. But the unethical behavior that results from misaligned incentives has cast the investment management profession in very bad light.

Headlines are full of print about greedy hedge fund managers and rogue traders. Even Charlie Munger who we quoted earlier has said, “On Wall Street, if they’re talking they’re lying and if they’re quiet they’re stealing.” Certainly our office in Camarillo, California is about as far away from Wall Street as you can get, but we thought it would be a good time to remind you that we never participate in any of the sleaze that unfortunately takes place in our industry. We don’t take commissions. We are never compensated by choosing one vehicle over another.

We have no conflicts of interest with our clients and if we make a mistake, we take ownership.

A recent CFA Institute poll indicated over half of their members point to a lack of ethical culture within financial firms as the leading cause of the current lack of trust in the financial industry. Our clients should know that our objectives are aligned with yours, we have a zero-tolerance policy for ethical breaches, and we have strict adherence to ethical codes and standards. There is never a question about wrong incentives or the behavior that goes with them.

### **Bernzott Small Cap Value Fund Ranked #1**

Bernzott Capital Advisors is proud to announce that Lipper, as reported by the Wall Street Journal, has ranked the Bernzott U.S. Small Cap Value Fund the #1 small-cap value fund in terms of performance for the year ending March 31, 2015. There were 308 funds in the category, ranked by total returns.

Years ago, we began exploring a mutual fund solution in order to serve our smaller accounts more effectively from both cost and portfolio management perspectives. As a result, we announced the launch of BSCVX, the Bernzott U.S. Small Cap Value Fund. The biggest advantage of using BSCVX is the diversification now available for smaller accounts. In addition, the mutual fund is now accessible to clients with smaller accounts who generally do not qualify for our separate account management.

The performance is only for the twelve months ending March 31, 2015, and we realize a one-year number is not indicative of our long-term success. But such an accomplishment does help tell our story of the value of looking for great companies to buy at attractive prices. What makes the performance number even more incredible is the performance does not reflect the defensive nature of our portfolio management. We will gladly cede high-flying performance in exchange for downside protection which preserves client's capital. In the end, however, we are glad that our portfolio management

can achieve good absolute results while taking an appropriate amount of risk.

BSCVX is managed with the same buy list as all of our separately managed accounts. So even if you do not own BSCVX directly, the ranking gives you a good idea of how we have performed relative to hundreds of other managers.

*Some of the Fund's expenses were waived and/or fees reimbursed otherwise these results may have been adversely affected.*

*An investor should carefully consider the Fund's investment objectives, risks, charges and expenses. An investment in the Fund is subject to risks and you could lose money. The principal risks of investing in the Fund include, but are not limited to, risks associated with investing in small cap companies & value oriented securities. This and other important information is contained in the Fund's prospectus, a copy of which may be obtained by calling (800)856-2646 or by visiting the Fund's website at [bcafunds.com](http://bcafunds.com). Please read the prospectus carefully before investing. Distributed by IMST Distributors, LLC.*

### **Other Happenings at Bernzott**

We are proud to announce that Bart O'Conner has joined Bernzott Capital as Director of Business Development. Bart spent almost ten years at Cadence Capital Management in Boston where he was a managing director and head trader. While at Cadence, Bart developed enduring relationships with many senior managers in a variety of firms. Bart will be in charge of increasing awareness in Bernzott Capital and our performance. He is based in Hingham, Massachusetts.

Finally, we are happy to announce that client service officer Denelle Rutherford delivered a healthy baby girl in May. Mom and daughter are resting at home for a few weeks before Denelle returns to her post at Bernzott. We want her to take as much time as she needs, but we sure miss her in the office. Congratulations, Denelle.

#### About the Firm

**Bernzott Capital Advisors** is an independent institutional money manager serving foundations, endowments, public and private retirement plans including Taft-Hartley plans, and businesses, individuals, trusts and families. Please feel free to call with questions and comments, or visit us at [www.bernzott.com](http://www.bernzott.com).