



GUERDON T. ELY, MBA, CFP®, AIFA®

# Prudence in Practice

*Making Common Sense Common Practice*

## Welcome to Wall Street's Nightmare

One of my hobbies is working on golf telecasts for the different networks. A few years ago, when I was working for CBS at the AT&T Pebble Beach Tournament, there was a backup on the twelfth tee, so I went over and sat on a nearby rock wall to wait for my group's turn to hit. Since I was focused on the golf, I never noticed that another gentleman had joined me on the wall until I felt his hand on my shoulder. I turned and was face to face with one of those famous people you know but don't ever expect to meet; with his left hand still on my shoulder he stuck out his right hand and said, "Hi, I'm Alice."

Alice Cooper's appearance is a little different, but his manner is very friendly. We sat and talked golf stories and then he got onto a very funny story about Groucho Marx. Alice said that after coming home from a concert, he was too wired-up to sleep so he would go next door to his neighbor, Groucho Marx, who had insomnia. They would stay up all night watching old movies. Their friendship grew and the originator of shock rock was himself given quite a shock when Groucho showed up at one of his concerts. There, in the middle of the front row, was the octogenarian, Marx, in full tux with his date, Mae West, in her best evening gown. My surrealistic moment got even more dreamlike when Cooper's story was interrupted by a very distinctive raspy voice. When I heard "Hello Alice," I didn't even need to turn my head to know that Clint Eastwood was standing right next to me.

Cooper, Marx, West, and Eastwood are all very different people, but they have one thing in common, carefully crafted public personas created to sell concert and movie tickets. Cooper, the shock rocker; Marx, the smart aleck; West, the sex symbol; and Eastwood, the tough guy, know that in a world anxious to escape reality, image sells. However, rock stars and movie stars aren't the only ones who know that image sells; Wall Street knows it, too, and does it very well. They sold the image and we bought their products. We are now in a serious financial crisis because, contrary to what they advertised on their websites, Lehman Brothers wasn't "innovative" enough, Merrill Lynch wasn't "smart" enough, Bear Stearns wasn't "strong" enough, Standard and Poors wasn't "independent" enough and Countrywide said, "yes," too much.

While temporarily escaping reality is the whole point of entertainment, facing reality is how we survive and prosper in life. The reality is that greed and opportunity replaced common sense, judgment, responsibility, and integrity on Wall Street. The opportunity was a massive amount of money being generated by the emerging economies in China, India, and elsewhere, looking for a safe place to invest. The solution was fixed income securities, ultimately backed by US real estate. The problem was the feeding frenzy created to capture all that cash which led to real estate loans being issued without any credit checks. These risky loans were then bundled together and packaged and repacked into various types of interest-bearing securities. In an incredible conflict of interest, the securities were shopped to the various rating agencies, which were more than willing to sell their souls for the right price. Using assumptions that had nothing to do with reality and everything to do with greed, they were able to turn a sow's ear into a silk purse. Backed by these phony ratings and their image as the financial experts of the world, Wall Street spread this worthless paper all over the world.

In the illusionary world of movies, action heroes rule. In the financial world, Wall Street ruled because they were seen as the action heroes. They were James Bond, Indiana

Jones, Batman, Iron Man, the Hulk, and Hellboy all rolled into one giant super hero who could provide super returns with no risk. They got this image because the world has come full circle and is coveting the tree of knowledge once more. During the industrial age, power belonged to those who controlled or had access to resources, capital, and infrastructure. As the world shrank, access to information became more important than access to assets. Having assets was not nearly as valuable as identifying who had them and who needed them. In a world with limited resources and unlimited information, power has once more shifted. Since everyone has access to information and resources are becoming scarce, the real power is held by those who know how to use information and assets most efficiently and effectively. In this new knowledge age, Wall Street was seen as the holder of financial knowledge.

Unfortunately, Wall Street's image as the financial knowledge expert was no more real than Alice Cooper's shock rock image, but the nightmare they welcomed us into was all too real. Blinded by greed, Wall Street dug a tunnel to riches and the world rushed in to get the gold. However, in the quest for gold, it is as important to shore up the mine shaft as it is to dig it. Too late the world found itself in an unstable mine filled with nothing but fool's gold. The ensuing collapse crushed the world's financial markets and the countries, companies, and individuals dependent on them.

The world has learned a harsh lesson that Andre Agassi was wrong when he said in his camera commercials, "Image is everything." With Theodore White's book, *The Making of a President*, we first became aware that TV and now digital media have made image more important than substance in the selling of politicians and virtually everything else, including Wall Street, because it is easier to manipulate an image than it is to manipulate reality. Just as a lie repeated enough times becomes accepted as truth, so an image reinforced often enough seems real. And once this image has been accepted as real, knowledge has a difficult time penetrating the illusion.

Knowledge is impotent against the illusion because we want to believe the image is real. The playwright, George Bernard Shaw, commenting on this phenomenon said, "The moment we want to believe something, we suddenly see all the arguments for it, and become blind to the arguments against it." Even the smartest among us can be blinded to reality as was illustrated by the Congressional testimony of Alan Greenspan, the former Fed Chairman, when, in explaining how we got into this mess, he used words like "shocked disbelief", "beliefs shaken", "too much faith", "failed to anticipate", "flawed", and my favorite, "the intellectual edifice collapsed."

The reason the intellectual edifice collapsed is that knowledge alone will never be enough but knowledge wisely applied will. Wikipedia may not be the most authoritative source but I think they got it just right when they said, "An aspect of knowledge that has been largely forgotten in knowledge economy thinking is wisdom. Wisdom invokes questions of judgment, ethics, experience and intuition, all of which are necessary for the best application of knowledge." Wall Street's image has been tarnished not because it failed, but because it can't be trusted. When I was just starting my career a good friend told me, "Take care of the clients and the money will take care of itself." Wall Street either never knew this or they forgot it. Either way it needs to regain its moral authority or it is in danger of losing its position of financial leadership to London.

If Wall Street is to be trusted again they must not only accept accountability, they must seek it. Boards of directors must stop being sideline cheerleaders and start doing their job. They must approve and actually review policies and procedures and they must diligently monitor and evaluate performance. I thought we learned our lesson with Enron and their do nothing board, but apparently not. Compensation packages have to be redone so management is more concerned with long term sustainability than quarterly profits. The way things stand now, management has every reason to take big risks because they are rewarded exorbitantly for big short term profits and fired for trailing peer company quarterly results. And finally, regulatory audits have to be real

reviews. Most audits have more to do with determining the organization of a company's paperwork than the ethics of its behavior or the suitability of its products. These three steps may not cure all of Wall Street's problems but they are essential emergency measures in controlling the greed that has infected Wall Street.

Entertainers survive and prosper by creating images that are based on the larger than life illusions. Wall Street's image cannot be based on illusion because in the real world it is impossible to sustain the illusion indefinitely. The only sustainable image is one based on a combination of knowledge, hard work, and integrity; it is called "a good reputation." Wall Street can do it because, as Alexis de Tocqueville observed, "The greatness of America lies not in being more enlightened than any other nation, but rather in her ability to repair her faults."

ELY PRUDENT PORTFOLIOS, LLC  
10 DECLARATION DR., SUITE D  
CHICO, CA 95973

(530) 895-0636 OR (800) 560-0636  
WWW.ELYPORTFOLIOS.COM  
GTELY@ELYPORTFOLIOS.COM