

# The Age of Independent Advice

## The Remarkable History of the Independent Registered Investment Adviser Industry



### Chapter Four: Dark Clouds with a Silver Lining

**This is the fourth of six chapters excerpted from Schwab Institutional’s book on the history of the RIA industry. The 1970s and 1980s were marked by stagnant business activity, rising unemployment, and inflation. Yet during this same period, there were silver linings and innovations born of adversity that set the stage for the emergence of independent advisers as an important force in the financial services industry. Tax Reform, the introduction of the world’s first money market fund, and changes in retirement laws proved beneficial to the independent advisor industry.**

Two weeks after Loren Dunton and his colleagues met in Chicago to launch the financial planning movement—which would dramatically change the scope of the independent advisory profession—President Richard Nixon signed into law a piece of legislation with an equally important effect on investors and their advisers. The Tax Reform Act of 1969, Nixon declared, represented “a sweeping revision” of the tax code: it would close loopholes that had allowed “far too many of our citizens to avoid the taxes that others have had to pay.”

The act was indeed far-reaching. But it was not a panacea nor could it prevent the financial troubles on the horizon.

The social upheaval of the 1960s—which saw the Cold War, the Vietnam War, urban riots, and political assassinations—had been offset, paradoxically, by a financial boom. But as the 1970s dawned, the economic good times came sputtering to an end. Inflation turned to “stagflation,” a newly minted term to describe the unprecedented combination of stagnant business activity, rising unemployment, and inflation. Loan rates soared, but interest on savings accounts stayed legally capped at low levels. Between 1970 and 1981, stocks languished in the worst bear market since the 1930s. In early 1973, the Organization of Petroleum Exporting Countries (OPEC), sharply raised oil prices; in October of that year, OPEC imposed an oil embargo to punish the United States for supporting Israel in the Yom Kippur War. The price of a gallon of gas quadrupled, from 30 cents to \$1.20, and

desperate drivers waited in long lines at gas stations for limited supplies. Not surprisingly, by 1975 consumer confidence, as measured by the University of Michigan’s sentiment index, plunged 40 percent from the decade’s earlier high.

Yet there was a silver lining in the dark economic clouds. Motivated by difficult times, investors turned increasingly to the emerging financial planning profession. As Loren Dunton later observed, “One of the misconceptions prevalent in the 1970s was that people turned to financial planners in growing numbers because a growing number of people were calling themselves financial planners. While that may be partially true, people actually started turning to financial planners because of the growing complexity of their financial lives.”<sup>1</sup>

There were other silver linings as well, innovations born of adversity. The debut in 1971 of money market mutual funds generally enabled savers to earn higher returns than those yielded by bank savings accounts. The remarkable growth of money market funds—from 8 percent of all mutual funds in 1975 to 37 percent in 1982—helped introduce millions of American savers to mutual fund investing.<sup>2</sup> The Employee Retirement Income Security Act of 1974 (ERISA) introduced safeguards for employee retirement plans and required that they be prudently managed. And on May 1, 1975, in an event known on Wall Street as “Mayday,” the Securities and Exchange Commission abolished fixed pricing of brokerage

## Dark Clouds with a Silver Lining

commissions. One consequence was the emergence shortly thereafter of discount brokerage firms such as Charles Schwab & Co., Inc., which offered trades to customers at sharply reduced prices. In the years after Mayday, independent advisers and discount brokers developed mutually beneficial relationships, with brokerage firms providing execution, custody, and other back-office and related services that helped take independent advisers to a new level of success.

### “AN INSIDIOUS THIEF”

During the 1960s consumer prices rose an average of 2.5 percent a year. By itself, that figure wasn't cause for alarm; previous ten-year periods had experienced similar inflation rates. But the averages belied serious weaknesses in the economy. Spending on the Vietnam War and President Lyndon Johnson's Great Society programs had generated deficits. And the effects began appearing at decade's end: the inflation rate jumped to 4.7 percent in 1968, then to 6.1 percent in 1969. Meanwhile, unemployment rose, economic growth retreated, and productivity fell. The 1973–74 bear market drove stock prices down by 40 percent; the market's recovery over the next few years was slow and uneven. For the decade of the 1970s, after adjusting for the value lost to inflation, stocks delivered a total return of *minus* 13.24 percent. The figure for government bonds was minus 16.01 percent. As economist J. Bradford De Long observed in his study of 1970s inflation, “The sustained elevation of annual inflation to the 5- and 10-percent-a-year range for a decade has no parallel in any other period of America's past history.”<sup>3</sup>

The impact of 1970s inflation cannot be overstated. Retirees on fixed pensions despaired as their purchasing power shrank by half over the decade. Younger people worried about covering living expenses that were expected to triple or quadruple by the time they retired. President Gerald R. Ford, for his part, called for Americans to “Whip Inflation Now” by wearing WIN buttons—a futile attempt to encourage savings and disciplined spending.

Independent advisers and financial planners were affected as well. Indeed, inflation played an important and positive role in shaping their profession.

In 1969 August C. Hansch had founded Financial Profiles, a service bureau in Carlsbad, California, that gathered and

processed client information to generate financial plans. (After a 1998 acquisition, the company became a leading provider of financial planning software.) In the 1970s, Hansch's planning methodology placed inflation front and center. Writing at the end of the decade, he called inflation “an insidious thief...made more dangerous by its quiet but inexorable destruction of our savings.” His firm faced the “thief” squarely. “The first query on our questionnaire is, ‘On a scale of one to nine, how concerned are you about making sure that your long-range investments keep pace with inflation?’”<sup>4</sup> Addressing their clients' fears and concerns about inflation helped Hansch and other early financial planners build the credibility of their new profession.

### TAX REFORM'S UNEXPECTED CONSEQUENCES

Inflation wasn't the only concern of financial planners and independent advisers and their clients. The Tax Reform Act of 1969, the first modern legislation labeled as “tax reform,” opened a Pandora's box of complications. The law established new tax rates and also introduced the alternative minimum tax (AMT), in effect a parallel income tax system with its own rates and rules. Targeted at a few wealthy taxpayers who took advantage of legitimate exemptions and deductions to zero out their taxable incomes, the AMT had an unexpectedly broad impact: it affected not only the wealthy few but also taxpayers whose taxable incomes were close enough that they *might* be subject to the AMT. Furthermore, because the AMT brackets weren't indexed for inflation, every year more taxpayers were swept into its system.

Seven years later, with the passage of the Tax Reform Act of 1976, Congress sent another strong signal. The first major legislative effort to crack down on tax shelters, the 1976 act disallowed tax deductions for losses on certain types of investments in which the investor had little or no economic risk. It also applied tight restrictions to deductions for home offices and vacation property rentals, and the proceeds from the exercise of stock options were classified as ordinary income instead of capital gains. The act's centerpiece was an overhaul of the estate tax: for the first time, estate and gift taxes were unified, and the new law mandated carryover basis for inherited property, which provoked a storm of protest.

Though the carryover-basis provision was canceled before it could go into effect, other changes in the estate and gift

tax remained confusingly in place and many estate plans immediately became outdated. Once again, taxpayers' need for expert financial assistance suddenly increased beyond what many CPAs and tax attorneys could offer, and some taxpayers found themselves consulting financial planners, investment specialists, and estate planners. Other people needed substantially revised estate plans.

The 1976 act had indeed instituted reforms. But it also introduced a new level of complexity to many Americans' financial lives.

### THE RISE AND FALL OF TAX SHELTERS

As tax laws changed, inflation worsened, and returns from stocks and bonds remained in negative territory, some investors—even conservative investors—looked for a creative escape route. They thought they found one in limited partnerships that owned hard assets such as real estate or oil and gas. The partnerships' appeal was twofold: they were widely viewed as better inflation hedges than stocks, and they afforded tax write-offs that could be used to shelter other income. Partnerships appealed to salespeople as well—including some who called themselves financial planners—because they offered higher sales commissions than mutual funds.

As limited partnership sales became more popular, Congress grew concerned. After its initial assault on tax shelters in the Tax Reform Act of 1976, Congress repeatedly tightened restrictions on them through the early 1980s.<sup>5</sup> Finally, Congress decided to lower the boom once and for all. The landmark Tax Reform Act of 1986 made dramatic changes, collapsing the number of personal income tax brackets to two from fourteen, reducing the top personal tax rate to 28 percent from 46 percent, equalizing tax rates on income and capital gains, and subjecting a larger number of taxpayers to the alternative minimum tax. Most importantly to many financial planners and their clients, the law introduced “passive loss” rules that effectively prevented individual investors from taking tax-shelter deductions. The changes quickly put the tax-shelter industry out of business, while posing serious challenges to many financial planners as well.

The changes “drove out a whole element of the financial planning industry that was very, very different [from other planners]—folks who needed big commissions and who never would have survived advising clients about mutual

funds,” says Kurt Cerulli, president of Cerulli Associates, a financial industry research firm.

### “WHY NOT A MUTUAL FUND?”

Those who stayed needed to recommend other investment products to their clients to replace tax-shelter partnerships. “As the commission-oriented advisers looked around for something else to sell,” Peggy Ruhlin recalls, “mutual funds came to the forefront. At that time, load mutual funds were paying commissions of eight or eight and a half percent. It wasn't what they got on tax shelters, but it was better than nothing.”

Financial planners and other independent advisers weren't unfamiliar with mutual funds, which had been a popular product during the bull market of the 1960s and which still represented the bulk of many client portfolios. But for fee-only advisers and planners, who did not accept commissions, mutual funds posed a challenge. They used no-load funds, which had to be bought and sold separately through the mail by the client from each fund family distributor. No centralized order execution or custody service was available. Commission-based planners, on the other hand, had access to their broker-dealer affiliate's trading and custody services to handle load funds for their clients.

Whatever their compensation base, planners turned to mutual funds after 1986 as their overwhelming investment of choice. “There were some people, as there are today, who managed individual stocks and bonds,” says Harold Evensky of Evensky & Katz, an independent advisory firm based in Coral Gables, Florida. “But that wasn't a viable solution for most people. Mutual funds were the only realistic investment product for us.”

Mutual funds weren't merely a “realistic” option: they also proved to be a remarkably successful one. Between 1970 and 2006, total assets invested in mutual funds grew more than two-hundred-fold, to \$10 trillion.<sup>6</sup> At the end of 2006, *each* of the eleven biggest individual mutual funds was larger than the industry's entire \$47.6 billion in assets in 1970.

The numbers are especially relevant for independent advisers, who have shown a preference for investing their clients' money in mutual funds. With so much at stake, independent advisers have a clear interest in prudent and effective fund industry management.

## Dark Clouds with a Silver Lining

The story might have turned out differently if it hadn't been for an innovation that changed the future of investing for independent advisers and the clients they served. That innovation was the money market fund, and it was invented not by a government agency or a Wall Street powerhouse firm but by two financial consultants with a good idea.

First, though, some background. During the 1970s banks and savings and loans were prohibited from paying more than the rate designated by the Federal Reserve Bank—then 5.5 percent. Loan rates, on the other hand, had no caps. For corporations and institutions that could afford to buy them, money market instruments—such as commercial paper, Treasury bills, and bank certificates in denominations of \$100,000 or more—were very attractive because, being unregulated, they could pay market rates. For small savers, the picture was very different: when interest rates rose above 5.5 percent, as they did during the 1970s, those small savers were stuck. Banks lent money at double-digit rates and returned only 5.5 percent in interest.

There was nothing to be done about it until Bruce R. Bent and Henry Brown, who owned their own small financial consulting company on Wall Street, fastened on the problem. Bent and Brown couldn't start a bank and pay higher rates. How could they invest savers' funds at market rates and offer a decent return?

Bent later described his epiphany: "I was at my desk, looked up at my partner and said, 'Why not a mutual fund?' I didn't know anything about mutual funds at the time, but I thought it could work. Everyone said it was impossible....I read the regulations and nowhere did it say it couldn't be done. People simply lacked the imagination to make it happen."<sup>7</sup>

The world's first money market fund, which Bent and Brown called The Reserve Fund, launched in late 1971. It allowed investors to pool their money and make short-term investments in money-market instruments that paid 8 to 9 percent—a far better return than savers were getting on passbook accounts. The fund got off to a slow start, but that changed dramatically after the *New York Times* published a story about the venture on January 7, 1973, headlined "Overnight Mutual Funds for Surplus Assets." The following Monday, Bent and Brown fielded a hundred phone

calls from people who had read the story. "By the end of the month, the fund had \$1.8 million in assets," one chronicler later wrote. "By the end of the year, it had \$100 million.... The big mutual fund companies quickly introduced money funds....Investing would never be the same."<sup>8</sup>

The success of money market mutual funds seems paradoxical. The funds were introduced at a time when many households had no interest in or knowledge about mutual fund investing. Moreover, most mutual funds invested solely in stocks (there were a few bond funds and balanced funds), and declining values had made the stock market unappealing. However, savers were clamoring for higher yields on cash deposits, and money market funds, whose return rates were in the high teens, were the only place for average investors to find them. While not guaranteed by the government, money market funds were relatively safe and highly liquid. Also reassuring was the fact that, unlike long-term stock and bond funds, money market fund shares remain at a stable value day by day. Money market funds attracted vast numbers of new customers to the mutual fund industry, and their growth persisted as yields rose throughout the late 1970s and early 1980s: By the end of 2006, money market mutual funds totaled \$2.3 trillion, about a quarter of all mutual fund assets and roughly eight million times the amount of money in The Reserve Funds at the end of 1972.

For mutual fund companies, money market funds were a boon because, in industry jargon, they were "sticky": they helped retain customer assets as well as grow them. Previously, investors selling shares in stock or bond funds had to take their money out of the fund industry and return it to bank or brokerage accounts. Now the proceeds could be placed in the fund family's money market fund, earn a market yield, and be conveniently redirected to another long-term fund investment at any time.

| Money market funds growth 1975-2000<br>(in billions) |                 |          |
|--|-----------------|----------|
| Year-end   | Number of funds | Assets   |
| 1975   | 36              | \$ 3.70  |
| 1980   | 106             | 76.36    |
| 1990   | 741             | 498.34   |
| 2000   | 1,039           | 1,845.28 |

Source: Investment Company Institute, *Mutual Fund Fact Book* (Washington, DC: 1992, 2004).

| Long-term mutual funds growth 1940-2000 |                 |                                 |   |
|---|-----------------|---------------------------------|---|
| Decade ending in                        | Number of funds | Assets (in billions of dollars) | Percentage change in assets over decade |
| 1940                                    | 68              | \$ 0.5                          | —                                       |
| 1950                                    | 98              | 2.5                             | 400                                     |
| 1960                                    | 161             | 17.0                            | 580                                     |
| 1970                                    | 361             | 47.6                            | 180                                     |
| 1980                                    | 564             | 134.8                           | 183                                     |
| 1990                                    | 3,079           | 1,065.2                         | 690                                     |
| 2000                                    | 8,155           | 6,964.7                         | 554                                     |

Source: Investment Company Institute, *Mutual Fund Fact Book* (Washington, DC: 2004).

This advantage was especially beneficial to no-load fund companies that dealt directly with their customers. Seizing the opportunity, fund sponsors that had previously been specialized asset managers now positioned themselves as full-service investment providers.

Independent advisers and planners also benefited from the introduction of money market funds, which gave them another option to offer their clients. And they profited indirectly from another landmark event: the abolition of fixed brokerage commissions on May 1, 1975. *Time* magazine announced the upheaval in dramatic language: “To stockbrokers, Mayday means nothing less than the abolition of the system that has enriched them in good times and pulled many of them through during long periods of market slack. What is more, negotiated—or ‘unfixed’—

commissions will begin a drastic restructuring of the securities markets.”<sup>9</sup> Actually, it was the securities industry, not the markets, that was transformed. Brokerage firms consolidated, discount brokers emerged for the first time, and new products and ways of business—including those offered by independent advisers—flourished in the more open, competitive environment.

**THE RETIREMENT REVOLUTION**

That environment was also being transformed by seismic changes in the American way of retirement. The revolution had begun back in 1962, when Representative Eugene J. Keogh, a Democrat from New York, sponsored legislation to create a new retirement vehicle. What became known as Keogh plans gave self-employed people, partnerships, and other unincorporated businesses the same access to tax-advantaged retirement plans that only corporations had previously enjoyed.<sup>10</sup> Over the next two decades, further changes in retirement laws, especially those favoring self-directed or individually owned retirement vehicles, would prove beneficial to independent advisers, who saw them as a way to attract clients who needed planning, advice, and asset management in addition to retirement savings.

John B. Keeble III exemplified this entrepreneurial type of adviser. As a Vanderbilt College student in the early 1950s, he’d taken a part-time job selling life insurance. But when he was offered a full-time position, he turned it down. “At the time, most insurance companies used about a two-and-one-half percent factor,” Keeble later wrote. “Retirement planning, through an insurance company, was grossly inadequate at that time.”<sup>11</sup> Instead, Keeble became an attorney for the Internal Revenue Service, a post he left in the 1960s to open a firm in Atlanta called Financial Service Corp. Its mission: securities and insurance sales to fund Keogh plans. Rich White, a chronicler of the early financial planning profession, tells of how Keeble, a private pilot, “confined his market to the territory he could reach conveniently within a one-day flight. To help sell his Keoghs, he filled out pages of client data and then fed the data through a computer to produce an automated financial plan....At the height of its growth in the 1970s, Financial Service Corp. trained and employed hundreds of salesmen, who were to branch out and start dozens of new organizations in its mold.”<sup>12</sup>

## Dark Clouds with a Silver Lining

Keeble served as the second president of the International Association for Financial Counseling, which later became the International Association for Financial Planning. He advocated broadening the expertise of financial planners beyond a single discipline such as insurance sales with which they had typically started their careers. “Keeble... came to the conclusion that if a salesman were to sell both life insurance and mutual funds...in conjunction with a comprehensive financial plan, he would serve the consumer better,” another history recounts.<sup>13</sup>

The Keogh plan had been targeted at self-employed individuals and small businesses. Other retirement-savings innovations had far more widespread implications. ERISA, enacted in 1974, tightened restrictions on defined benefit pensions, at the time the most common form of pension offered by corporations to employees. The Individual Retirement Account, or IRA, also created in 1974, permitted individuals not participating in employer retirement plans to set aside money each year, tax deferred, until they reached retirement age. And the employer-sponsored 401(k) plan, introduced in 1981, allowed employees to contribute up to 15 percent of their salary to the plan while deferring taxes on that money until it was taken out of the plan. The tide was shifting away from employer-funded retirement and toward today’s defined-contribution model, in which workers take responsibility for their own retirement savings.

The numbers tell the story. Between 1982 and 1986, when IRAs were available and all workers younger than seventy and a half were eligible to make tax-deductible contributions, the amount contributed to IRAs jumped sharply, from \$4.8 billion in 1981 to \$38.2 billion in 1985.<sup>14</sup>

ERISA’s landmark provisions were designed to help protect traditional defined-benefit pension plans, but the law’s requirements actually helped contribute to a decline in their use. As more employees turned to self-directed or individually owned retirement vehicles, independent advisers found their services in high demand. After all, participants in traditional defined-benefit plans need little or no advice. When they retire, they start receiving monthly checks; when they die, the checks cease. But 401(k) plan participants often need asset allocation and investment

selection advice. And rollover IRAs, which eventually serve as the collection points for 401(k) assets, are fully under the ownership and control of the account holder. Account holders find they need investment advice during the accumulation years, and they need even more advice on arcane distribution regulations during the withdrawal years—even if they haven’t sought investment advice in the past.

“Our research shows that people actually act differently about their retirement money than they do about their other investments,” says David Hunt, a director of McKinsey & Company. “Historically there’s been an argument in the industry about self-directed investors, people who like a little guidance, and people who give the adviser full discretion. Those segmentations break down when it comes to retirement assets. A \$800,000 rollover probably presents you with the single largest financial decision you’ve made since you bought your first house. [With smaller amounts], you might have gone online and done a little asset allocation on your own. But it’s much more challenging to make that decision for \$800,000. Now you want advice in a way you didn’t before.”

Multiply that decision by the number of baby boomers now entering their sixties—America’s largest-ever “retirement class”—and you have a huge and ongoing opportunity for independent advisers.

### FROM “PLANNER” TO “INVESTMENT ADVISER”

By the time the U.S. economy finally began to recover, in 1982, the mutual fund industry had matured considerably. Yet public acceptance hadn’t quite kept pace; some investors still weren’t ready to switch from the individual stocks they’d traditionally preferred. “We take it as a given now,” says Kurt Cerulli, “but in the early 1980s, the mutual fund wasn’t really front and center. People were buying individual stocks. It was the traditional ‘get an idea from your broker and buy it’ approach. It was all transaction-based and all commission-based.”

Many financial planners continued to stick to fee-only planning and let clients arrange their own investments. Gradually, though, they began to realize that it made sense to offer investment advice as well as planning. As a business proposition, financial planning on its own was not very profitable. But when it was coupled with investment

advice, for which ongoing fees could be charged based on the amount of assets under management, it suddenly became more attractive. A 1 percent fee applied to a client with a \$1 million account, for example, would generate \$10,000 in annual revenue, enough to cover the cost of planning and advisory services for the client and contribute to overhead and profit. One hundred such clients could make for a financially viable advisory practice.

Mutual funds became the investment vehicle of choice for several reasons. For one, funds were highly regulated. They were also relatively transparent—for example, funds are obliged to disclose their holdings twice a year—and straightforward to analyze. Diversification, low cost, and liquidity gave them an advantage over individual stocks and partnership interests. “Mutual funds played beautifully in the independent registered investment adviser market in many ways,” says Cerulli. “A lot of the advisers throughout the 1980s were mutual fund asset allocators. They were able to put together diversified portfolios as the mutual fund vehicle became embraced as a mainstream product. The rise of equity investing and the general concept of diversified portfolios converged to make mutual funds attractive.”

Fee-based planner-advisers tended not to promote a particular product—or any product at all, except advice. Their primary offering was objectivity. These planner-advisers “had no reason to choose one fund company or one fund provider over another,” Cerulli says. “And there was no reason to buy and sell funds to generate a commission. Their compensation was based on managing

a portfolio of mutual funds. So their interests were more aligned with their clients’.”

Independent advisers using this model had to become skilled in analyzing and comparing mutual funds and their managers. As the number of funds grew from five hundred to more than three thousand during the 1980s, more and more advisers turned to a single resource for guidance: the mutual fund data service Morningstar.

“Advisers weren’t necessarily experts on individual stocks,” recalls Morningstar managing director Don Phillips, “but as the world moved from stocks to mutual funds, they felt they were equal to the challenge of identifying, selecting, and monitoring good mutual fund managers.”

Morningstar was founded in 1984 to give individual investors useful information about mutual funds, but it wasn’t long before financial planners and independent advisers became Morningstar’s largest market. They remain so today. Many advisers believe that Morningstar’s powerful tools played a key role in the growth and success of the independent advisory industry.

“If you’re a little boutique or sole proprietor adviser, there’s no way you can research stocks and bonds independently,” says Peggy Ruhlin. “You’ve got to be working for a [large firm] or another institution that can do that research for you. Mutual funds gave a different approach to the game, but there was still the problem of research. Morningstar came along and solved that, giving us the tools to do our own research. We didn’t have to be associated with a big broker-dealer—we now had the tools to do it on our own.”

## Dark Clouds with a Silver Lining

---

### **Bruce R. Bent, Co-Inventor of the Money Market Mutual Fund**

The co-inventor of the money market mutual fund grew up in modest circumstances, one of five children of a post office employee and cafeteria worker. Young Bruce Bent started working when he was nine, and was working full time by the time he was fourteen. He served in the Marine Corps and then earned degrees in economics and business. By 1971 he was 33 and working with Henry Brown in their two-person financial consulting business on Wall Street. Most of their clients lacked the \$100,000 or so it took to buy high-yielding instruments such as commercial paper. So Bent and Brown invented the money market mutual fund, which allowed smaller investors to pool their money and enjoy the money market's higher returns. Brown put up \$100,000 of his own money to start The Reserve Funds in 1971; Bent put up nothing, and earned only \$11,000 in salary in the fund's first year. In its second year he earned nothing. The two men went shopping for shareholders, contacting 125 brokerage firms, insurers, and other prospects. None invested. "We were exhausted financially and emotionally," Bent later told *Time* magazine.

Then came fame in the form of a January 1973 article in the *New York Times*. In less than a month the company's assets rocketed from \$400,000 to \$1.9 million. In 2005, Bruce Bent was named to *Financial Planning* magazine's Hall of Fame, recognizing the "26 entrepreneurs and investors whose achievements have shaped the business of financial advice." Today, Bent's company, The Reserve Funds, is worth more than \$40 billion and is ranked among the 25 largest mutual fund companies in the United States. In addition to his position as chairman of the company, Bent is a popular speaker on financial topics.

---

### **Morningstar, Invaluable Insights on Mutual Funds**

Two men were responsible for creating and shaping the world's first mutual fund data service: Joe Mansueto and Don Phillips. Mansueto, a securities analyst, founded Morningstar in 1984 in his Chicago apartment to fill a gap he'd observed between the growing interest in mutual funds and the amount of information available to individual investors. Later that year he published the firm's first product, the quarterly *Mutual Fund Sourcebook*. Don Phillips, who had earned a master's degree in American literature, joined the firm two years later as its first mutual fund analyst and, soon afterward, became the editor of its flagship publication, *Morningstar Mutual Funds*, a comprehensive guide to more than seven hundred funds. It quickly became the firm's most popular product.

"When Morningstar started we had no clue about the financial planning world," says Phillips. "We were just thinking like investors. We liked to invest in funds. What's the information we would want to know? We had no idea that this revolution was going on in financial planning—moving from selling products to finding the best possible investments for their clients."

"It turned out we had the exact same mindset as independent advisers did. We wanted to look objectively at where to put money. And that was the way they were thinking. This audience really found us. We didn't go out and target it. And it was a perfect fit."

Throughout its history, Morningstar has continued to develop innovative information resources. Morningstar Principia, introduced in 1991, was one of the first software programs that financial advisers could use to analyze stock funds. Morningstar.com, the first of the company's Internet platforms, contains information and research on stocks, mutual funds, ETFs, hedge funds, and 529 college savings plans. Between 1998 and 2001, the company embarked on an overseas expansion to Japan, Australia, New Zealand, and Canada.

Today Morningstar serves more than 4.9 million investors and 185,000 financial advisers around the world.

---

## Dark Clouds with a Silver Lining

1. Loren Dunton, *The Financial Planner: A New Professional* (Chicago: Longman Group USA, 1986), 7.
2. Investment Company Institute, *Mutual Fund Fact Book 1997* (Washington, DC), 19.
3. J. Bradford De Long, *America's Only Peacetime Inflation: The 1970s*, National Bureau of Economic Research Paper No. 84 (Cambridge, MA: 1996), 2.
4. August C. Hansch, *Controlling Tomorrow* (Rockville Centre, NY: Farnsworth Publishing, 1980), 68–72.
5. Internal Revenue Service, *Legislative History of Abusive Tax Shelters* (Washington, DC: GPO, n.d.) 1, [http://www.irs.gov/pub/irs-utl/i.b.\\_history\\_of\\_shelters.pdf](http://www.irs.gov/pub/irs-utl/i.b._history_of_shelters.pdf).
6. Investment Company Institute, *Mutual Fund Fact Book* (Washington, DC: 1992, 2004).
7. Bruce R. Bent, chairman of The Reserve Funds, in "Wall Street Museum Honors Bruce Bent and Celebrates a Milestone in Financial History," a statement issued October 8, 2001, on the 30th anniversary of the launch of the money market mutual fund.
8. Mary Rowland, *The Fidelity Guide to Mutual Funds* (New York: Simon & Schuster, 1990), 35.
9. "Prosperity Blunts 'Mayday's' Edge," *Time* magazine, April 28, 1975, <http://www.time.com/time/magazine/article/0,9171,917397,00.html>
10. Employee Benefit Research Institute, *Retirement Plans for the Self-Employed*, Section 17 (Washington, DC, n.d.), <http://www.ebri.org/pdf/publications/books/fundamentals/fund17.pdf>.
11. John B. Keeble III, "The Race to Capture Assets: Will Insurance Companies Emerge Victorious?" *Journal of Financial Planning*, August 2000, [http://www.fpanet.org/journal/articles/2000\\_issues/jfp0800-art14.cfm](http://www.fpanet.org/journal/articles/2000_issues/jfp0800-art14.cfm).
12. Rich White, "A Preliminary History of the Organized Financial Planning Movement Part I (1969–1974)," *The Financial Planner*, September 1979, 21.
13. E. Denby Brandon Jr., and H. Oliver Welch, *A History of the Financial Planning Movement: A White Paper* (Denver: Financial Planning Association, 2003), 11, [http://www.fphistoryproject.org/fphistorywhitepaper\\_aug2003.pdf](http://www.fphistoryproject.org/fphistorywhitepaper_aug2003.pdf).
14. Sarah Holden, et al., *The Individual Retirement Account at Age 30: A Retrospective*, (Washington, DC: Investment Company Institute, 2005), 4.

The information provided here is for general informational purposes only. Although all reasonable efforts have been made to make sure that the information contained in this chapter is accurate as of the date of book publication, the publisher disclaims any liability with respect to the accuracy or timeliness of that information.

Copyright ©2007 The Charles Schwab Corporation  
San Francisco, California 94104

All rights reserved. No part of this chapter may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage and retrieval system, without permission in writing from The Charles Schwab Corporation.

Published by The Charles Schwab Corporation, San Francisco, California  
Mutual Fund OneSource®, Mutual Fund Marketplace®, Schwab Institutional®, SchwabLink®, Schwab Performance Technologies® and Charles R. Schwab IMPACT Award® are registered trademarks or trademarks of Charles Schwab & Co., Inc., used with permission.

Certified Financial Planner Board of Standards, Inc. owns the certification marks CFP® Certified Financial Planner™ and federally registered CFP (with flame design) in the U.S., which it awards to individuals who successfully complete CFP Board's initial and ongoing certification requirements. Financial Planning Standards Board Ltd. owns the CFP® Certified Financial Planner™ and CFP (with flame design) marks outside the U.S. and its territories.