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Questions and Comments

We welcome any questions or comments that you may have, on any investment matter. I am happy to answer them directly in person, or in a future newsletter. Please e-mail your questions to me at choran@assante.com

New Chris Horan Website

Past newsletter articles, quotes from clients, and my personal background are now posted on my new website. If you would like to look at past newsletters or refer a friend or family member interested in finding out a little more, check us out at:

www.assante.com/advisors/choran/

Freedom, Gratitude, and Scandal

As we approach the Holiday season in December 2003 the US mutual fund industry is in the gun sights of New York State Attorney General Eliot Spitzer. It seems that certain investment companies allegedly granted benefits to favored customers, at the expense of other, smaller investors.

These allegations appear on the heels of recent scandals ranging from Bernie Ebbers at Enron, Conrad Black, and all the way to Prime Minister Chrétien and the Hotel du Mers. The general theme is that these people and others are alleged to have used their positions of influence to deal themselves inappropriate or illegal benefits. Some of these benefits were outrageous, like Ebbers' US \$6,000 shower curtain in his US \$18 million Manhattan apartment, paid for by Enron, according to The Wall Street Journal.

The fantastic riches that corporate executives were allowed to deal themselves through stock options are another example of inappropriate benefit.

Many executives dealt themselves fantastic paydays (John Roth at Nortel cashed in \$60 million) *when they had very little or no capital at risk*. Their options were just a lottery ticket. The personal benefit was all out of proportion to their contribution to the company. They confused a rising stock market with their management skill. They cashed in entrepreneurial pay cheques without having taken entrepreneurial risk.

Is our system rotten? Let's see.

Our system is based on individual liberty and rule of law. Liberty means the freedom of individuals to decide how to run their lives. We can set our own goals, work as hard or as little as we like, and think our own thoughts. As consumers, we have the freedom to

demand the products and services we want or need. We also have the right to decide our career, or to start a business.

'Rule of law' is simply the general framework of laws that protects us from the capricious power of the state and others; it is what gives 'The Little Red Hen' the power to defend her bread from the lazy neighbors who would take it from her.

Under these principles runs the free enterprise market economy. The market economy is simply the seemingly chaotic mechanism by which goods and services are exchanged. The economy works best (and produces the greatest improvements in standard of living) when people are most free to make decisions about what to buy, and also when they are most free to decide what to *produce*, to best satisfy their customers.

The economy is all about consumers (not the glitzy 'consumerism' associated with the Holiday season) - the freedom of you and me to decide what to spend our scarce money on. The freedom to buy from businesses in competition with each other, and the right to be regulated by a government that serves at our pleasure, in our interests.

Sometimes it seems we take our freedoms for granted. We forget that our free-market economic system has been forged, one piece at a time, over more than 300 years. Too easily we take the side of the critics, who argue that success is a matter of luck, and not hard work. We too easily allow government regulations to convey a benefit on one group of people, such as farmers, to the detriment of consumers through higher prices (and also to the detriment of the poorer nations who would sell us their farm produce). We too easily agree to regulation without question (why do we have the LCBO? or Air Canada?).

We should pause, in the holiday season of 2003, and take a long moment to reflect on the marvelous market system that has allowed the innovation and industry of our people to supply us all the things that we have today. We should be deeply and reverently thankful that we have the good fortune to be alive today, under the Western principles of liberal democracy.

Even a cursory glance at world history will show that our Western society alone has been able to harness the industry, the creativity, the technology, and the capital, in a chaotic but cooperative system, to allow our people to dream, discover, drive toward, and ultimately to produce the highest standard of living, across virtually the entire population, on all measurable criteria, in the history of humanity. The *average* person in our society today has a better standard of living than the kings and queens of only 100 years ago.

What does this have to do with corporate scandals?

These deals strike at the heart of our system. They encourage us to respond with more government intervention and increased regulation: more unproductive bureaucracy. They weaken the arguments in favor of free enterprise. They give some credence to the otherwise incoherent arguments of the socialists and others who would take apart the system that has given us all that we have today.

As The Economist points out, 'the widespread and quite outrageous abuse of capitalism, by capitalists, threatens to weaken the forces and arguments that would otherwise defend liberty'.

What are we to do? We must differentiate between the markets for goods and services, on one hand, and the individual players in those markets. The markets are the all-important mechanism by which individual consumers decide whose products and services to buy, and producers decide how to satisfy those demands.

On the other hand, a company, or business, or government, exists only to serve us, the consumers, the citizens. If there are certain individual companies, or people in those companies, who are breaking the law then they ought to be punished. Capitalists ought to know better, and that makes their abuses less forgivable.

Where laws are fuzzy, such as those relating to insider trading, or 'the public interest', they must be simplified and clarified. Regulations, if they are required, should be designed above all to allow markets to work as freely as possible to the benefit of the consumer.

Government regulators must be watched closely to ensure they don't smother us with useless bureaucracy, while pushing their own empire-building agendas.

Where inappropriate behaviour is suspected, the allegations must be made before courts, not by zealous bureaucrats in front of sensationalist and uneducated news media.

(The mutual fund industry is a prime example of useless regulations: a 'simplified' fund prospectus, the supposed magic wand of investor protection, is an unintelligible 300 pages!)

Probably most importantly we need to sharpen our own thinking about these issues. We need to think more clearly about what is right and what is wrong. When the Prime Minister intervenes to facilitate a loan to a bankrupt hotel adjacent to a golf course in which he has an interest, and gives the excuse that he was just doing his job as PM, we need to stamp our foot and say 'Nonsense!'

We should not be afraid to speak up and defend our system from those who would usurp its benefits for themselves. We need to engage each other in collegial debate about these issues.

We must recognize that our system is unique in history, that it is fragile, and needs protection. We need to understand that we are responsible, in a democracy, for defending the principles that our society is founded on. The ethical system that will guide us through the 21st century will be the ethical system that we agree on.

The point is this: problems in companies or in markets do not imply that capitalist free enterprise doesn't work. The system works. The evidence is the staggering abundance around us. We just need to defend it better. It is a democracy, after all. In the end, we will get what we voted for.

In closing, I would like to say a most sincere thank you. Thank you for the continued privilege of helping you look after your investment portfolios. Clients continue to send their family and friends to me, for which I am very grateful. I continue to be responsible for more than \$50 million on behalf of about 120 families, a responsibility that I take very seriously. I look forward to working with you all over the coming years to achieve the great goals that you have for yourselves and your families.

All the best to you this Holiday Season, and in the coming year – 2004!

Footnote: Evidently consumers didn't like what they heard about the problems that Spitzer had with Putnam, the US money management firm: they moved \$21 billion of their money out of the firm in just 2 weeks, or about 10% of Putnam's total assets, an 'unprecedented' shift, as reported in the Wall Street Journal. The customers, through open markets, are punishing Putnam. It may be a start.

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