

Taking Stock: Don't let 'sniffers' nose around proprietary software

by Malcolm_Berko

Dear Mr. Berko: I have a proprietary stock market formula that uses various unit trusts to generate long-term gains and or income for my clients. I've only been in this business for five years but my record is very good. I purchase unit trusts with zero commission costs and specific stock market objectives to match the investment of my clients. Each account will own six to eight unit-trusts with maturities of at least 12 months. I charge 1.25 percent a year and have \$54.6 million under management. My clients are low-risk investors. They are happy because the risks are low and the results are very good and I'm happy because I have a "Magic Bullet" (that's what my wife calls it) that hits the target my clients give me. Now my manager told me that we are going to be visited by a New York Stock Exchange auditor (he calls them "pretty boys") next month and that they will want me to show them how my system works, explain how I select the specific unit trust objectives and how I determine what percentage of a client's portfolio is invested in each category. I don't want to disclose my formula. I perfected it over five years and it belongs to me. It's proprietary and if I disclose the methods, then anyone can use it and I have nothing unique to present to clients. My manager is no help and tells me that I have to provide it to them if they ask for it. I know you've been around a long time and I would appreciate any advice or help you can give me.

Concerned in Illinois

Dear Concerned in Illinois: Settle down. I've been in this business before you were in knickers, going on 45 years to be exact, and watched a lot of water flow over the dam. And I've met dozens of "sniffers" (that's what veterans in this business call them) who visit the branch offices of Merrill Lynch, Dean Witter, Prudential, Oppenheimer, etc. However, most sniffers wouldn't know a blue chip from a buffalo chip; think that Moody's is a Bible study course and the 30 Industrials is a new NFL franchise team. Their visit to your office may be the first time they've left home on their own.

They're not bright lads and don't have to be because they are hired to count things and make sure that the cleaning crew isn't pilfering the petty cash. Sniffers count rolls of toilet paper, copy machine usage plus incoming and outgoing phone calls. They check filing cabinets for rust deposits and secretly film the maintenance people to catch security violations. Then they scoot around the office with puppy dog enthusiasm hoping a secretary will invite them home for dinner. Sniffers are not the sharpest tools in the shed and most have passed the Dale Carnegie personality course ... so they're usually friendly lads. But when they interview you to discuss your accounts, be sincere, even if you don't mean it. And always call them "sir" and respond with a "Yes, sir" or "No, sir." They love to be called "sir."

However, you do not have to disclose your proprietary methods with a sniffer or the New York Stock Exchange. Neither a sniffer nor the exchange has the right to your data. And if they request disclosure, then you have the right to ask for "specific authority," which is similar to a warrant. In that case, you have time to prepare pages of mysterious gobbledygook with colored graphs, statistical probabilities, projections, pictures and give it some fancy title. But not to worry: according to recent autopsies, the brains of most sniffers are sculpted from moldy cottage cheese and can't discern fact from fiction.

I'm familiar with your unit trust concept and it's a swell way to use the power of diversification, various management techniques, measured risk control, diverse category selection and sector timing in a managed portfolio to generate appreciation and/or income. We have a close acquaintance who uses his proprietary construct to purchase unit trusts for managed accounts and his record is similar to yours. We are impressed with its simplicity, its success and low cost and from time to time, under our banner, we employ his expertise in managing some of our accounts. But more importantly, he, too, was asked to divulge his proprietary methods a few years ago. And because this is a family paper I can not repeat the manner of his refusal. Needless to say, he's never been asked again. So hold your water and if a sniffer gets up close and personal, have him call me.

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