Birth of the Scarsdale Investment Group

Hildy Richelson and Stan Richelson, October 13, 2022

In 2011, Stan and I, published the second edition of *BONDS: The Unbeaten Path to Secure Investment Growth*. The book is a leader in the niche bond field.

Our book was *the* bond book for Bloomberg Press, then part of the Bloomberg empire, a privately held financial software, data and media company headquartered in Midtown Manhattan, New York City. A second edition was published by John Wiley & Sons.

We decided to tell you how we began to invest in bonds and write the first book for individual investors on bond investing, *Income Without Taxes: An Insider's Guide to Tax-Exempt Bonds*, and how we created our bond investing business.

How We Began Our Study of Bonds

Searching for answers to difficult questions has been an exciting journey for us. As rookie investors (like so many of you) we scoured the media for advice on how to accumulate assets and build wealth. Obviously, we discovered a plethora of advice-givers dispensing sage suggestions and trumpeting "can't miss" schemes on how to get rich.

We decided to sort the wheat from the chaff, the bombast from the reality.

Our Transition from Stocks to Bonds

Like all Wall Street investors, we had a "system" on how to buy stocks.

When we started out, we were young. Stan decided that he would try "market-timing" in stocks. No-load stock mutual funds had been recently created so, for the first time, no fees were charged in buying and selling the stock funds. So, we could become stock traders!

Stan identified the five most aggressive stock mutual funds and jumped in. Naturally (brilliant lawyer that he was), he thought he had a clever system. When he perceived that the stock market would be going up, he bought the five funds. If he sensed that the stock market would be going down, he sold the five funds. If he deduced that the market was going up, but it went down more than 10%, he automatically sold all the funds.

How could this system fail?

After three years of this shrewd trading, Hildy asked Stan: "So, how did we do?" Stan answered: "We might have broken even."

Ouch.

Hildy was not pleased. She thought that breaking even was a loss because three years of compounded interest failed to materialize: zero, nada, nothing.

So… Stan bought his first bond.

We gave up stock trading and looked for some better way to make money by investing. We knew that, generally, there were two types of easily traded major investments: stocks and bonds. An accountant we had befriended suggested investing in tax-exempt municipal bonds. That was all he bought, he said.

Stan decided to buy some bonds. We lived in New York City at the time which had, even then, high state and city taxes. We were told that New York municipal bonds would avoid three levels of taxes: Federal, New York State and New York City.

It sounded promising.

Buying bonds was quite easy: one phone call. Stan telephoned John, his friendly broker and said: "I want to purchase five New York bonds," which meant he wanted to purchase a bond that would repay $5,000 face value on its due date. At that point, this was the sum total of his knowledge about bonds.

John, the broker, sold the five bonds to Stan for 100, which in bond-speak is $1,000 per bond, for a total of $5,000. When Stan reviewed the confirmation, he noted that there was no broker commission. The broker was friendly, but Stan knew John was not in the charity business. So, he called John and said: "I see that you left your commission off the confirmation. Is that a mistake?" "No," he replied, "we sell the bonds flat."

When Stan asked John to speak English, John said that bonds are traded on a "spread" between what price the broker paid for the bonds and their sale price to the retail buyer (that's us). John, further explained that he doesn't make a commission, he "earns a piece of the spread as does the house."

Huh?

Stan quickly realized that he didn't understand what was happening in his "simple" purchase of a bond. He was relying on John to represent him in this trade in the bond market. Stan was wrong. John, his friendly broker (who Stan was relying on as his advisor), actually represented himself and the brokerage house. John did not represent Stan.

So, here was the lesson: Stan was in a transaction in which John had a clear conflict of interest (which was not resolvable). Stan was on his own. Brokers are motivated to sell to their customers the bonds with the biggest spread to maximize the broker's profit on the trade.

Tough world out there.

So… Stan bought his second bond.

The next month, Stan had another $5,000 to invest in bonds. Stan called John and asked him to find another New York bond for him to buy. This time, Stan inquired what the cost of the bond would be. When John answered that the cost is 100, Stan, knowing nothing of what the best price would be, responded: “98”. John countered: “I cannot sell you the bonds for that price.” When Stan asked “Why?”, John said: “because I do not have the authority to change the price.” Stan questioned: “Who has that authority?” John replied: “The trader.” Stan requested to speak to the trader. John stated: “The trader does not speak to the customer.” Stan then asked John to convey both his best wishes and his bid of 98 to the trader.

Well, the broker <u>did</u> convey the information – and came back with a price of 99.

The lesson from this simple story explains how the bond market works:

- The house owns the bonds that it sells to retail investors
- the broker represents the house
- you, the customer, are on your own

Understanding what bonds are and how they work will even the odds of you performing well – and profiting – in the bond market.

<u>Hildy and Stan Write the First Bond Book for Individual Investors</u>

As late as the mid-1980’s, when we wrote our first book about investing in bonds, there were no guides for solo investors on investing in individual bonds. Corporate bonds were traded in an institutional market, as were Treasury and Agency bonds. Brokerage firms were interested in selling stock, as they still are today.

Stan was asked by a friend to have lunch with a prospective client, a book publisher named Richard. (Stan was highly motivated since the lunch was free and the restaurant was five-star.)

This lunch was a turning point in our life.

The publisher knew that there were no books for an investor on how to purchase individual bonds. As a result of the lunch, he believed that Stan was astutely knowledgeable about municipal bonds. Stan <u>did</u> know more than Richard. At that lunch he asked Stan if he would be interested in writing a book about the subject.

Stan came home from that meeting. He said he was too busy to write. He was an astute tax lawyer, after all.

Then he made the best decision of his life!

He asked Hildy if she would like to write the book.

Hildy was a stay-at-home, PhD mom at the time, having left her university job teaching anthropology. Like many women (then and now) finances were not an integral (or even a little) part of her mindset. This did not seem to be an endeavor of interest to her.

Stan refused to accept that. There were large insurance policies on Stan's life. He was concerned that in the event of his early demise, Hildy would not do well dealing with and investing an inheritance when facing the self-serving brokers of Wall Street.

In an attempt to address the problem of his possible premature departure, Stan then suggested that if Hildy had no interest in money and investing, they should visit the U.S. Trust Company and create a trust in order to protect her. Thus, in the event of Stan's untimely saintly ascension, the proceeds of the insurance policy would be put in a safe trust.

The meeting was a disaster. The patronizing representative of the trust company only addressed Stan, ignored Hildy and continued to talk over her head. Hildy realized that without her trusted partner she would be floating in the financial soup.

On the way out of the door, an epiphany! She stopped, gave Stan a determined look, and declared: "I will write the book!"

Two years later, in 1985, our first bond book, *Income Without Taxes: An Insider's Guide to Tax-Exempt Bonds,* was published by Carroll & Graf. It was a great success for a book of its genre. It was cobbled together from piles of articles collected by a librarian we hired, and whatever Hildy could find published by the rating agencies.

It was the first book written to guide individual investors on how to invest in bonds.

It was written from an outsider's point of view—a view which we still retain as investors in bonds.

It took an outsider to write the insider's guide—because the insiders did not want to reveal the secrets of the trade. No money in it.

Conclusion

Investing is a minefield. How do you tiptoe through the financial landscape without blowing up your financial life? Soon after *Income Without Taxes* was published, people started calling and asking for our help in buying bonds of all kinds. That is how our business was born. We were living in Scarsdale, New York, at that time and so we named our business the Scarsdale Investment Group, Ltd. The Ltd was used to add a little class to the name.

Our business model was and is unique:

We only represented individual investors in the bond market. We are Registered Investment Advisors who are fiduciaries with no conflict of interest. We do not work for a brokerage firm. We hold no inventory of bonds. We have no conflict of interest. Our goal for clients is to buy the highest quality bonds at a fair price. We charge low fees for our service.