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Wealth Management

Who Is Managing Your Portfolio?

How to tell if your financial adviser is a salesperson

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If you visited a doctor who, after seeing you, prescribes a particular medicine, should you pay his fee and buy the drug? Most likely. If, instead of a doctor, you saw a neighbor who happened to have a similar condition and thereby recommended the same medicine, would you go right out and buy the drug? Would you pay your neighbor a fee?

Fortunately, in the health care industry, there are strict standards that doctors and other practitioners must meet to professionally assist others, including many years of education, training and certification. Unfortunately, in the investment industry, standards are not quite that high. Passing a relatively unchallenging test after a couple weeks of modest preparation can gain a person the right to present investment ideas and products to the public.

Though there are financial professionals who have seriously studied investments and are committed to using their analytical acumen for the benefit of clients, the vast majority of people calling themselves financial advisers or consultants are merely salespeople capable of "talking the talk" without a clue as to how to "walk the walk." With such salespeople, on the occasion that one gets, largely by coincidence, sound advice, one will still have wasted substantial money on commissions, wrap fees, and other schemes designed to discretely bleed assets. More often, accounts drained by sales-related charges can be additionally and more seriously hurt by losses from imprudent investments introduced by reps well versed in industry jargon but intellectually unqualified to make proper portfolio recommendations.

Without question, a person who provides a service deserves a fee. In investments, it is important to recognize whether an actual service or merely access to a service is being provided. We pay for a plumber to fix a leaky pipe. We do not pay for a plumber consultant to call the plumber, who we then have to pay as well. Because we all have a natural resistance to pay commissions, in the investment arena the words "sales" and "reps" are rarely seen anymore. Salespeople are now called financial consultants and financial advisers. Many even have the title Vice President, usually indicative that they have drained more assets from clients than their peers.

As there are real consultants and advisers who directly plan and manage portfolios for individuals without sales fees, how can you tell if your adviser is merely a salesperson draining 20 percent or more of your investment earnings from your savings into his or hers? Here are some signs:

1. You have paid any front-end sales load for a mutual fund. All mutual funds charge fees for administration and all nonindex funds charge fees for management of the assets. These are the only fees that are necessary and merited. All other fees are a waste of assets. If you paid a sales charge to get into any of your funds, you have been had by a salesperson.

For instance, assuming the sales charge was 5 percent, you handed your rep and his bosses in the sales department 5 percent of your money. If you invested in a bond fund, you blew away all of a year's earnings. No matter what type of fund chosen, that 5 percent is never recouped. If your $50,000 investment in that 5 percent loaded fund grew to $95,000, you would have had $100,000 instead. The $2,500 initial sales charge had a longer-term impact of

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$5,000. Whatever type of security or asset class you seek, know that there are many no-load (meaning no sales charge, or "load") funds of equal or better quality than any of the sales loaded funds that might be presented to you by a sales rep.

2. You own any "B" or "C" share mutual funds. The only thing worse than a fund charging a sales fee upfront is one that charges sales fees upon withdrawal, while also charging excess "marketing" fees on your assets every day. B and C class mutual fund shares were created so investors would not feel the sting of a front-end sales charge while sales charges could be collected nonetheless. Salespeople will often inform clients that the investment is a long-term one and that the liquidation fees only hit if shares are liquidated in the first few years. Most salespeople neglect to inform their clients that an extra fee, usually .5 percent to .75 percent per year, is taken out of their clients' accounts while that back-end penalty exists. That extra fee is purely sales commission that goes to your rep (and his bosses, etc.). In most cases, 'B' and 'C' shares incur even higher fees than front-end loaded shares of the same funds.

3. You pay more than $20 for trades. Trading is now completely electronic and costs brokerage firms only pennies per trade. Allowing for normal reporting and a reasonable profit, buying and selling stock should cost between $5 and $20 per trade. If you are paying more, you are simply paying too much, with all of the difference damaging your returns while helping your salesperson achieve higher bonuses.

4. You have a brokerage 'wrap' account. A brokerage wrap account is one in which you have agreed to pay a set fee, often a percentage of assets but with a minimum dollar amount, for the right to execute a certain number of trades without further charge. Theoretically, it takes away the incentive for salespeople to encourage excess commissionable trades. In practice, it takes away incentive for salespeople to help you at all. But the fee is collected, and guarantees a fairly high level of commission for the salesperson and his or her firm. The charts below shows how damaging to you, and conversely how profitable to your salesperson, a wrap account can be.

5. Your mutual funds are in a fee-charging consolidation program. A number of institutions present a large selection of mutual funds that can be reported on single statements and provide free transfers between funds. No-load fund groups and a number of discount brokerages offer this service for free. Other institutions charge hefty fees, often as much as 1.5 percent of assets annually. If your salesperson put you into one of these programs, such as "Trak" at Smith Barney or "MFA" at Merrill Lynch, your investment earnings are probably being reduced by 15 to 30 percent, given average market returns over time. Unlike management and administrative fees that allow funds to function, the charges for these programs are merely sales fees shifting your assets to your adviser and his sales colleagues at about the same rate as the brokerage wrap program displayed in the accompanying charts.

6. Your adviser presented you with an age-based asset allocation. A salesperson pretending to advise will often present pointers that sound wise and thereby instill confidence. A clear sign that your financial guru is actually a simple-minded rep is if you are presented with an asset allocation recommendation based on age. Such an allocation model, usually with rounded percentages that change each decade you are closer to 90, or 80, or whatever, is easy to remember and presents a superficial logic. It also ignores actuarial reality, appropriate risk-tolerance application, and inheritance. People who survive to 60 will likely survive to 85 or so — hopefully longer. A horizon of 25 years at age 60 is no different than a horizon of 25 years at other ages. Growth to the extent one's tolerance for risk allows should be sought. Because one's hair is gray is no reason to sacrifice the returns that might best beat inflation. Moreover, if there is to be any estate to pass on, the age of the descendants is more pertinent, and yet equally moot. If your "adviser" gave you a piece of paper with the bond allocation going up 10 percent every 10 years of your life, you've got a real winner (not).

7. Your cash is earning less than t-bills (currently 3 percent). If you have an "adviser" and your cash is earning less than treasury bills, you have a salesperson. Most money market instruments pay more than t-bills. A real adviser would not let you earn less. A salesperson will put your funds in whatever institution he or she is working for, regardless of the rate being paid.

8. Your fee-paid adviser has others invest your money. Many people like to own individual securities and yet have their money professionally managed. A registered investment adviser (RIA) is a professional that can fulfill this goal. To provide a similar service, some salespeople push programs offered by their firms in which your money is managed separately by a fund company. The fund company charges you. Your salesperson's firm charges you. Briefly, you can go directly to an RIA. Much like the plumber consultant hypothesized earlier, you do not need to pay twice and have a filter between you and your money when you can pay once and be directly involved.

Before the technological improvements that have occurred over the past 30 years, brokers were needed to execute trades and representatives were needed to disseminate information and gather pooled assets. With transactions processed electronically and information available on every desk or lap with a screen, there is no longer any need for professional intermediaries who today add no intrinsic value whatsoever. If you want immediate diversification, you can invest in no-load mutual funds. The best fund groups present online and in-person assistance. If you want a private account of individual securities that is actually managed by the person with whom you speak, you can invest through a registered investment adviser.

But currently, if you are in any of the situations highlighted above, it is likely that the adviser or consultant currently assisting you is in fact a salesperson. Your payments to this individual have nothing to do with your investment returns, other than their assured reduction. There is no investment that can guarantee results. However, you can guarantee yourself lower expenses, which of itself should bring far better returns. ■