<u>Choosing the Right Investment Advisor is No Laughing Matter</u>

You want to hear a joke? OK, maybe it's not a joke, but it is kind of funny: people spend more time researching their purchase of a refrigerator than in their selection of an investment advisor.

And now that we think about it, it's really not all that funny. After all, how much does a refrigerator cost? What, one thousand, maybe two thousand dollars? A few thousand more, if you're really going nuts? And, once you buy it, that refrigerator will be with you for the next decade or two.

And how much might it cost you, over that same ten- or twenty-year period, if you pick an investment advisor that charges higher-than-average fees? Or, like the majority of American mutual funds, fails to beat its market benchmark? Of course, the answer will largely depend on the size of your portfolio, but we would hazard a guess that a poor choice in investment advisor is going to cost you a lot more than any old refrigerator.*

Which is why we'd like to help you find a good one. Investment advisor, that is. For refrigerator advice, please stop by your local Home Depot.

Here is a list of basic questions we think you should ask of any potential investment advisor. And if you happen to have hired someone already, perhaps it would be a good idea to use these questions as a checklist to see how much you know about the person who's minding your money. If you find there are some things you don't know but would like to, why not give him a call, or send her an e-mail, so that you can find out.

The Firm

The first questions to ask pertain to specifics about the firm, from services offered to fees to the people at the firm.

How long have you been in business?

What is the size of your firm?

How many clients do you have?
What are your assets under management?
What is the average portfolio size?

How are you compensated?

Types of compensation could be:

- *Fee only—asset-based, hourly, or flat fees. Many advisors charge a percentage of assets under management (typically 1%-2%). Hourly or flat fees are often associated with a specific, one-time service (such as developing a financial plan).*
- *Fee plus commissions—along with fees, some advisors may receive a portion of the commissions you pay when buying or selling certain financial products that an advisor might recommend, such as insurance policies or annuities*

- *Commissions only—advisors sometimes only receive compensation from sales commissions on the investments they buy and sell for you*
- *Wrap fees—asset-based fee for advice provided and execution of trades*

What services do you offer?

Services could include:

- *Money management—portfolios managed on a discretionary basis, and generally consisting of stocks, bonds, and other individual securities*
- *Financial planning—long-term financial planning in areas of retirement, college funding, wealth transfer, tax planning, and insurance.*
- *Wealth management—both money management and financial planning needs*

What are your credentials?

An advisor's credentials can tell you about his education and expertise. Some common credentials include:

- *CFA (Chartered Financial Analyst)—Must pass three exams, each of which demands a minimum of 250 hours of study and includes ethical and professional standards, fixed-income and equity analysis, alternative and derivative investments, economics, and financial reporting standards*
- *CFP (Certified Financial Planner)—After completing university-level financial planning coursework, must pass a 10-hour exam covering a variety of topics, from group medical insurance to derivatives.*

How are you regulated?

Have you ever been the subject of a lawsuit or governmental action?

Do you have any conflicts of interest?

Is your firm independent or owned by another company?

Investment Philosophy

The firm's investment philosophy is a very important factor in considering an investment advisor. Clients should understand and be comfortable with the way the advisor thinks about selecting investments and managing risk.

How do you select investments? What is your investment style?

Advisors may specialize in certain types of investments and styles (such as value or growth).

How do you manage risk?

What is your average holding period of an investment?

An advisor that trades too often might create added frictional costs, such as trading commissions.

Under what circumstances would you sell an investment?

How many securities do you recommend including in my portfolio?

Some diversification is important, but too much diversification might not be the best approach. Owning hundreds of stocks will just mimic the index and thus underperform the benchmark, due to the advisor's fees.

What information sources do you utilize to follow business and economic developments?

Do you consider taxes when making investment decisions?

While this might not be relevant in non-taxable accounts (e.g., IRAs), it is an important factor for taxable accounts, especially for high-earners.

Performance

While past performance is no guarantee of future results, it is still important to understand how the advisor has performed in the past.

What returns have your clients earned in the past year? In the last 3 years? In the last 5 years? Since the inception of your firm?

How are your returns calculated? What fees have been included and excluded in your calculations?

Some advisors report performance before their fees and some report after their fees. It is important to know this, so that an apples-to-apples comparison may be made between potential advisors.

How have you performed in down markets? In up markets?

An investment that has dropped in value by 50% has to gain 100% just to be back to even. Thus, preservation of capital is extremely important to long-term financial success. Asking how an advisor has performed in both up and down markets can tell you a lot about how well the advisor's investment style can preserve capital.

What benchmark(s) should I compare your results against? How do your results compare to the benchmark(s)?

A common benchmark for equities is the S&P 500. Other equity benchmarks may include the Dow Jones Industrial Average, the Russell 2000, and the NASDAQ, or the Barclays Aggregate index for bonds.

Administration

These questions mostly relate to how the advisor manages the administration of your account.

Who will be my primary contact at your firm?

Where will my assets be held?

An advisor should use a custodian that meets or exceeds the security measures established by industry and government regulators to protect your assets. Look for a custodian with important services like trade execution and preparation of monthly brokerage statements.

May I add money to or withdraw money from my account at any time? Are there any fees associated with adding or withdrawing?

What is the minimum account size you would work with?

Are there any penalties, costs, or restrictions for closing my account?

What is your privacy policy?

How often are your client portfolios reviewed?

What information should I expect to receive from you?

At a minimum you should expect to receive:

- *Account statements from the advisor or custodian where your assets are held*
- *Quarterly report showing holdings and year-to-date performance*

Conclusion

Choosing the right investment advisor is an important decision that should not be taken lightly. After all, it is your hard-earned money. You wouldn't want to buy the wrong refrigerator, so don't pick the wrong investment advisor, either. Take the time to make the right decision, and your portfolio will thank you for it later.

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* Consider a $250,000 portfolio that grows on average 5% each year. Over ten years, a 0.8% annual fee (the average charged by index funds) works out to cumulative fees of $24,236. Compare that to a 1.5% annual fee (slightly higher than the average mutual fund), which would have cumulative fees of $43,993. That works out to a difference of almost exactly $20,000. A $20,000 difference on a $250,000 portfolio is pretty darn significant—it could buy you ten refrigerators!