

# **Is Your Broker or Financial Advisor Hazardous to Your Wealth?**

## **The Secrets to Working with Financial Professionals**

**In this Special report you will learn:**

- **What you need from your broker and how much it really costs.**
- **How to determine the costs of mutual funds.**
- **The Brokers' Hidden Profit Center**

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A time may come, and it may be sooner than you think, that your "broker" or "financial advisor" will be a tiny microchip in your wallet. For now, brokers and advisors are real people or online contacts with real live people handling operations. However, because of the Internet and the fierce competition for your commission and consumer dollar, you have more choices than ever when the time comes to make a trade or seek advice.

Surprisingly, active traders often are willing to pay full or at least higher-than-rock-bottom fees to brokers with whom they have synergy. A broker who can get you research, initiate ideas, or is just a good sounding board, helps you make decisions and take action. Even professional money managers often use full commission brokers because they must have accurate adherence to their broker's orders and immediate compliance with buy/sell orders.

The differences among brokers and financial advisors are simple: commissions/price, level of advice and quality of service. The trick is to find the combination of the three that's right for you.

### **Wealth Principle #1 – You Pay for What You Get**

Brokers work for you. Don't think for a moment that you have to compromise just because you have a small account. If the person doesn't respond to your requests, ask to talk to the manager and have the account transferred to someone who will. You also have a responsibility not to be passive-aggressive with your broker. Don't say yes when you mean no, then complain that you were "taken." Don't get frustrated when you don't understand everything if you haven't taken the responsibility to learn. Don't begrudge a good broker the commission; everyone is entitled to make a living.

The level and amount that you will pay for broker and financial advisor services depends on which of the type of service you want and need.

### **The Difference between a Broker and Financial Advisor**

Sometimes the terms broker and financial advisor are used as if they are interchangeable, but they are very different. A broker is usually an independent agent, someone who provides a service. This person may be quite honest but will merely follow your instructions even if it may not be in your best interest.

A financial advisor is quite another story. This person is providing advice on your particular situation and goals, and is expected to act as a member of your inner circle. This also means that this person is expected to learn about your needs and work with you in a variety of areas. This can include financial and investment planning and counseling during market fluctuations.

Beware of titles and look at what that person is providing.

## **Advisory Fees**

Advisory fees usually take the form of a percentage of assets under management. I find many people are hesitant to pay these fees, preferring to pay commissions instead.

Which is better really depends upon the nature of the transaction. Commissions are quite often appropriate for a broker, since you are in charge and making the decisions. As long as you are not being intimidated by the broker, this may be a very cost-effective means of compensation.

However, for a financial advisor, advisory fees can be a better option for several reasons:

- You clearly know what you are paying and can try to eliminate the other fees described below.
- Commission and other fees like sales loads can lock you into your existing investments as they make it very expensive to make changes. This can create a conflict of interest which in my opinion should not be introduced into an advisory relationship.
- If you are not happy with the value you think you are getting for the fees you are paying your advisor, then get a new one. But be careful! A different advisor may offer lower fees, but you may be paying more through other costs.

## **Full service/full commission**

If you need advice, information, notification and ancillary services, you have no choice - choose a full service broker. If you are paying the full service commission, avail yourself of everything they have to offer. Your account should come with a clear monthly statement, immediate execution of trades, loan and market privileges and, most of all, they should be able to get you any stock, even a foreign issue, if you so request.

## **Discount brokers/discount commissions**

The levels of services at the discount houses are clearly reduced, but not to a point that you lose the personal touch altogether. Discount brokers can save you as much as 50% over full-service brokers, according to a sliding scale based on the dollar amount of the purchase. Many may not do research, or offer special conveniences like checking attached to your money market account, but some still do; you must ask.

They do provide margin accounts, consolidated statements, and pension accounts just like full-service brokers. Many will purchase no-load mutual funds for you and for a small fee (usually \$25-50 a year) will send you monthly, consolidated statements of your no-load funds. You can always talk to your broker as needed, and trades are usually fast and accurate. Many of these firms are really full service houses looking to get the discount business. As a result, even with their sliding scale commissions, you can negotiate for a greater level of service. Many discount brokers are already offering research and reports on stocks.

## **Deep discount brokers**

These firms give trading services only, but charge based on the number of shares bought regardless of the share price. For example, a deep discount broker may charge an \$8 service fee per trade plus \$35 for 100 to 3,000 shares, \$50.00 for 3,100 to 5,000 shares and \$0.01 per share over 5,000. If you are a heavy, active trader with no need for outside advice or research, this is your place.

## **E-brokers**

These companies compete on the low price/low service model, but most offer online research, some free and some at an extra charge. So why doesn't everyone use them? If the web is busy you might not get through, or you'll have to wait to put through a trade and miss the precise price point you targeted. Also, the various E-broker companies have differing account minimums and widely varying money market rates.

Good E-service means free quotes, accurate trades, clear and accurate monthly statements, access to customer service departments and speed of execution. The best way to judge is through trial and error and through consumer survey articles that rate services.

## **Wealth Principle #2 – Mutual Funds also have associated fees and costs.**

There are two types of mutual fund fees and expenses - the single shots and those that are ongoing. The single shots generally consist of one-time charges, like sales fees and redemption fees.

Sales fees or commissions associated with mutual funds are commonly called "sales load" or "loads". Loads are either front end or back end. Front-end loads are deducted before your money is invested. Back end loads, deferred sales charges, and redemption fees are all the same and all are paid when you withdraw your money. They are usually paid to the mutual fund company or the broker or salesman.

I strongly urge you to avoid investing in funds that charge a sales commission. When a sales commission is charged, possibly 4% to 5%, this means that you must outperform a similar fund without a commission by that amount just to match its performance. This is usually not an easy task. Furthermore, a sales load locks you into the fund. You need to stay in it for a long time to cover this cost and still get a competitive rate of return. When a commission is charged, you never know if your broker or advisor is favoring the fund that is best for you, or the one he stands to profit from the most. Often, if you do some detective work, you can find a similar fund without the commission, sometimes with the same manager

Redemption fees usually refer to fees charged for early redemption in order to discourage short-term trading and "market timing." These fees are not bad for the long-term investor, as long as they are reinvested into the fund and not pocketed by the fund managers, brokers or salesmen.

With redemption fees, the key is to ensure that the fee is paid to the mutual fund itself. In general, I prefer funds that do not extend their redemption fees longer than three to six months, unless they offer superior performance for their category with a very low expense ratio.

In addition to these one-time charges, there are ongoing fees that are charged every year and impact the performance of the fund, even for the long-term investor, including the expense ratio and brokerage costs.

The expense ratio is the total annual expenses of the fund, expressed as a percent of assets. It includes the management fee paid to the mutual fund manager, operating and administrative fees paid to run the fund, and 12b-1 fees used to market and distribute the fund. These fees (named after the SEC section that allows marketing and distribution costs to be passed along to you) are paid yearly.

The general rule with expense ratios is "The lower the better." New funds sometimes have high expense ratios because of their small size, but they should make every attempt to lower the expense ratio as they grow. This indicates a cost-conscious environment and a desire to put shareholders first.

Also, loads and fees may be specified by fund share classifications. The multi-class concept gives investors choice of load by creating different classes of mutual fund shares:

- Class A shares- front-end load.
- Class B shares, also called Class II, have a level load to attract short-term investors. Fidelity created 49 funds identical to each other except for the level load.
- Class C shares- 12-b fees plus redemption fees if you withdraw money before a specified number of years have elapsed.
- Class D shares- 1% front-end load plus 12-b yearly expense of .5%.
- Class N shares- back end load of 4.5% and an annual fee of 1%, or 1% redemption charge plus 12-b.

Finally, you should also be aware of assorted other charges that may appear in mutual funds:

- Charges to reinvest dividends can legally be as high as 7.25%. Watch out for this!
- Account opening and closing fees average \$75.
- Systemic withdrawal fees vary.
- Minimum account fees to discourage small accounts: accounts under \$10,000 are not profitable; some funds are charging service fees of \$10 a year.
- IRA and maintenance fees.

## **Are Mutual Fund Fees and Expenses Worth It?**

Do high fees buy better funds? No! Morningstar ([www.morningstar.com](http://www.morningstar.com)) concluded that higher costs result in worse performance because the fund tends to take higher risks to look good on the charts. Load funds have more volatility and choose stocks with higher price to earnings ratios.

Bond funds with high fees do even worse than equity funds with high fees and expense ratios. In 1994 (a bear year) A shares lost 3.78%, B shares lost 5.27%. Fees on the average B share were 6.4%.

As for the expense ratio, *Worth Magazine* did a study of 883 funds and found the average to be 1.33% a year. (A Morningstar study found a 2% average.) The spread is .17% to 8.9% with absolutely no correlation to investment performance. They reported that returns on the cheapest 10% were higher than returns on the most expensive 10%.

I favor index funds for several reasons. Academic research, as well as my own data, has shown that the choice of the stock category (large, mid-cap, small, growth or value) is more important than the actual individual stocks. It's analogous to the old saying about buying a home, "It's not the house; it's the neighborhood." My research has also shown that it is incredibly difficult for an actively managed equity fund to beat the S&P 500 over an extended period of time, and even more difficult to beat the category benchmark. A well-operated equity index fund can have an extremely low expense ratio, as little as 0.18% as compared to 1% or more for an actively managed fund.

When the expenses go toward management compensation, it can make a possible difference in select situations especially with small cap, global or exotic funds. Stocks in stock funds may be undiscovered, and more management talent (worth paying for) can be required.

### **Wealth Principle #3 – Spreads are the Brokers' and Advisors' hidden profit center.**

We all know about the commissions that brokers take on the buying and selling of your investments. There is, however, another fee built into the way that the stock market works. It is called the spread.

The spread is the difference between the bid and ask prices on a stock. Orders for stocks are taken and filled by the market maker. During the split second between the purchase and sale of the stock, the market maker has put its own capital at risk.

Here is an example in a more common transaction. Let's say Jane wants to buy Margie's Beanie Baby, and you, Rosie, are the market maker. You buy the toy from Margie, deliver it to Jane, collect the money and pay yourself. You get a fee from both Jane the buyer and Margie the seller, because you buy for a little less from Margie than you sell to Jane.

In the stock market, the fee is collected by buying at the bid price and selling at the ask price.

The NASDAQ has market makers in competition with each other. When you buy and sell stocks, or other securities on the open market, you make trades through your broker by way of agents for the market itself who specialize in the particular security in question. Buyers and sellers of stocks are not matched one-for-one at the market price. Rather, these market makers will sell you a stock at the ask price or buy your stock from you at the bid price.

The difference, "the spread," is part of the broker's profit. Dealers make their living by "taking the spread" on each transaction. This is their fee for making the market and keeping the market "liquid". That is, they will always have quantities of the stock to trade because they trade in such great volume.

For more information, go to [www.ChannelCapitalResearch.com/FollowtheFed](http://www.ChannelCapitalResearch.com/FollowtheFed) .

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## Praise for *Follow the Fed to Investment Success*

*"This is a great strategy for investors who actually have a job, a family and interests – in other words, a life."*

**Randall W. Forsyth – Editor, Barron's Online**

*"The Follow the Fed strategies defy the rules of conventional investing, and they work! Doug Roberts is right when he says we sometimes make investing way too hard. He has demonstrated that amazing returns that beat the market by large amounts can be made with only a trade or two a year. I recommend these strategies without reservation to anyone who wants to achieve superior returns while reducing the stress associated with investing."*

**Hilary Kramer - AOL / Finance Editor and Market Strategist**

*"When it comes to investing, Doug Roberts is the man to know. With his background at Wall Street firms like Morgan Stanley and Sanford Bernstein, he has learned all the tricks that allow those guys to literally print money. Now with his 'outside the box' way of thinking, he has a system that allows ordinary guys like me to get a piece of the action usually reserved for Wall Street insiders. The best thing of all is that I do not have to watch the market every day. I leave that to experts like Doug."*

**Eddie Hittinger, MD**

**Cliffside Park, New Jersey**

*"I have known Doug Roberts since his days at the Wharton School and have always considered him one of the smartest people I know. I have watched his rise through Wall Street. Over the years he has been kind enough to share his investing philosophy with me. These recommendations would have made me very rich, but I never had the minimums necessary for him to manage my money. Now Doug has developed a system that allows investors like me to invest like him, and I am jumping in with both feet."*

**Howard M. Gitten, Attorney**

**Fort Lauderdale, Florida**

*"Doug Roberts has been a lifetime member of the worldwide CEO Clubs for as long as me, and I am the founder.... Today, his business has blossomed because his wealth creating advice has made him a sought after expert on a topic most CEO's do poorly managing...Creating Their Own Wealth!!"*

**Joseph Mancuso**

**CEO Clubs Worldwide**

**New York, New York**

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**Barry Flanagan**

**Tap Consulting, L.L.C.**

**Granger, Indiana**

## Doug Roberts

### Biography



Douglas S. Roberts is the Founder and Chief Investment Strategist for the Channel Capital Research Institute. He is a Contributor to AOL's Money & Finance section and is frequently called upon by the media as an expert on the Federal Reserve Bank. His comments appear regularly on CNN/Money, MarketWatch.com, Reuters, and the Dow Jones Newswires, and he is a frequent guest on CNBC and the Fox Business Channel. John Wiley & Sons published Doug's new book, *Follow the Fed to Investment Success*, in May of 2008.

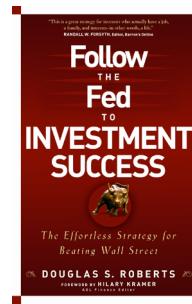
Doug was a Vice President and Portfolio Manager at Bernstein Investment Management and Research, a unit of Alliance Capital Management, L.P., from 1999-2001. In addition to his portfolio management responsibilities, he led his group's strategies focusing on quantitative investment analysis and sector allocation, as well as the evaluation of alternative asset investment vehicles.

From 1994-1998, Doug was a Managing Director of the Roberts Mitani Group, a New York merchant bank specializing in the investment of capital from Japan and East Asia. From 1992-1994 he served as a founding member of the Board of Directors of Benson Eyecare Corporation, which had been listed on the American Stock Exchange prior to its sale.

From 1985-1992, Doug was the Chief Operating Officer of the Flori Roberts/Dermablend Group, a family-owned pharmaceutical/cosmetic group of companies that were acquired for \$22 million in cash and stock by IVAX Corporation (IVX-ASE) in 1992. Subsequent to the acquisition, he served as Chief Operating Officer of the Personal Care Products Group and Assistant to the Chairman-Special Projects from 1992-1994.

Doug began his career as an Associate of the Morgan Stanley Group working in the Corporate Finance department in both the New York and London offices from 1983-1985. He earned a B.S. and an M.B.A. from the Wharton School at the University of Pennsylvania in 1983.

He serves on the international Board of Governors of Sigma Phi Epsilon fraternity and the Board of Trustees of the Ranney School and is a member of the Explorers Club for his participation in the discovery of the U-869, a World War II German submarine, off the coast of New Jersey as featured in the book, *Shadow Divers*. He holds a second-degree black belt in the Imperial system of tae kwon do. Doug is married with two children.



\*\*Special Bonus Report Data were obtained from the Kenneth R. French, PhD - Data Library (<http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/index.html>) and Standard and Poor's ([www.standardandpoors.com](http://www.standardandpoors.com)). Market indices include dividends except where noted. Actual live signals issued from ChannelCapitalResearch.com were used since 2006.

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