Understanding finacial adviser fees

Island Investor

By Don Freeman

LET'S be upfront and say that while no one likes paying fees, there is no such thing as a free lunch, and I, as a financial adviser providing financial advice, along with those on Wall Street who create investment products all need "to eat", so to speak.

That said, there is no reason for you to pay unnecessary or excessive fees for financial advice or investment products once you have a firm understanding of how financial advisers on Main Street earn their money.

Understand how financial advisers get paid

Financial advisers will usually follow one of the following compensation models:

Fee only

Financial advisers who are fee only will typically charge you a percentage of the account value they manage and they will tend to favor individual stocks, bonds and low-cost ETFs, because they cannot accept commissions from financial product sponsors. That's because fee only financial advisers have a "fiduciary responsibility" to choose investments which are in your best interest and not because someone is paying them a commission on an investment product. Just be aware that not all fee only financial advisers are the same, as some charge lower fees because they provide more basic investment management services, while others charge higher fees because they provide full financial planning services (a complete financial plan or roadmap, for example).

Commission only

Financial advisers who don't charge a fee will usually receive commissions from transactions and/or from those who create the investment products they sell.

And while there are commission only financial advisers who provide excellent financial advice, many others are merely good salesmen whose advice tends to be driven more by how they are being paid rather than by doing what's best for you, the client. For that reason, you can expect commission only financial advisers to steer you towards annuities and managed funds that pay them the highest commissions.

Fee based

So-called fee based financial advisers will charge you a fee and receive commissions on the products they sell.

This means they do not have a "fiduciary responsibility" to do what's in your best interest and that may end up costing you more than what a fee only or even a commission only financial adviser would charge.

Hourly rates or retainer

There are also some financial advisers who charge by the hour or a set fee – often to complete a special project that would otherwise be too complex even for a retail investor who is accustomed to managing his or her own money.

What arrangement is best for you?

Generally speaking, going for a fee only investment financial adviser who does not take commissions from those who create investment products like annuities or managed funds will end up being a better deal for you over the long term as they will steer you towards low cost investment products rather than those with the highest fees or commissions. Likewise, and even if you are an experienced do-it-yourself investor, there might be times when paying an hourly rate or a retainer will also make sense (a large or complex 401k roll-over for American investors). Just be aware that many fee only, as well as commission based financial advisers, will require a minimum sized account to manage before it makes sense for them to take you on as a full time client. However and even if your account balance is small, don't be afraid to check with a financial adviser to see if some kind of arrangement can be made to assist you if you need help.

Finally, no matter what type of financial adviser you use, make sure you take the time to understand what services he or she is offering for the fees you are being quoted. At the very least, your financial adviser needs to provide you with a detailed service and fee disclosure form.

Fees create a reverse compounding effect and reduce your nest egg over time. The higher the fees, in general, the greater the hit and reduced account size. Call me to discuss ways to reduce your portfolio fees and get your account growing efficiently.

There's no such thing as a free lunch. Photo: David Goehring

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Low minimum access to a Wall Street legend

Retirement Years

By David Mayes

I HAVE followed the performance of the Abraham Trading Company for many years but it has always been off limits for use with the vast majority of my clients. As has happened with a lot of high-class money managers recently, a low minimum feeder has been opened that allows access to your average offshore investor. What I like about the track record of this fund the most, is that they manage to have the occasional mammoth up-year and their down-years are very small in comparison.

Salem Abraham started the company in the late eighties, and since 1993 the company has managed to return a compounded average return of about 20% per annum. The monthly volatility is a little higher than some of my other favorite funds, but they have only had five down-years during this time, all but one of which were about 9-10%. The largest draw-down is less than that of the global MSCI index and had a very rapid recovery.

If past performance did accurately predict future performance, which unfortunately it doesn't always do, this would be the number one go-to fund. Luckily you can now hold this fund as part of a diversified portfolio for only US$10,000, meaning even a portfolio of $100,000 would be able to hold it as a 10% holding. In the past you would have needed millions to hold it in any reasonable proportion.

What also makes this fund a little different from many of its trend following peers is that its best years haven't been stock market crash years. Of course, it still does great in these periods and thus provides a certain amount of protection for a stock based portfolio. It made a whopping 158% in 2003, a rather unremarkable year for most, while making about 41% in the crash of 2008.

The new feeder fund does have an additional layer of management costs (although we can get into without paying any front or back end commission), but I have never had a problem paying up slightly for great managers. There is some truth to the saying that you get what you pay for, even though sometimes in reality you don't actually get what you pay for. With the top traders however, this is the truth and they have the track records to prove it. The only time to consider costs in my opinion is when you are indexing, since there is no alpha, or return above what the stock market gives, being generated. If you only want a market return, get a discount brokerage account to buy ETFs and do it yourself. There is no reason to pay anybody for what you could get by simply buying one global equity ETF.

If you want real alpha (which can be either a similar long term return as the stock market but with less volatility, or similar volatility but a much higher return), Abraham Trading Company has been delivering for 25 years. As with many others in this asset class, the last four years have not been great. This is an indicator that the timing is likely perfect to be getting invested. All previous periods of under performance have been followed by amazing returns. I have a feeling the next few years will likely see some large displacements in the global financial markets, which is the environment in which this fund thrives.

Stock market crash. Photo: zemistor

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