Mutual Funds

# 5 questions to ask before hiring a broker

Finding someone to guide you to the right mutual funds starts with knowing the right questions to ask. Here are the five most important.



By Timothy Middleton

If you called Merrill Lynch in 1999 looking for financial advice, you may have spoken to Curtis T. Matlach. "I was the BOD," he says, which stands for "broker of the day." Every big brokerage firm has such people, who usually are rookies in dire need of clients.

His qualifications: He had managed four Abercrombie & Fitch stores, and he knew how to sell. In that hot-market era, lots of salespeople jumped to Wall Street, where six months of training is all it takes to get a license to peddle mutual funds.

Matlach didn't work out at Merrill and ultimately set up his own investment advisory business in Tulsa, Okla. He says the problem with working as a broker is that "the salesman has more responsibility to his employer than they do to his client."

True. But brokers continue to control the investment decisions affecting a majority of the assets held by mutual funds. While we offer plenty of tools and advice on this site for investing on your own, some investors still prefer the comfort of working through a broker.

If you want a broker's advice on which mutual funds to buy, you want somebody who knows funds in and out and knows how to use them to build the best portfolio.

And that's not the only thing you want. You want somebody with a clean record -- and someone for whom you are an important client, even if you only have a small amount to invest. Finding such a person can be difficult, however, because the brokerage business is centered on the salesman, and a good salesman can sell snow cones to penguins.

For a portfolio that will work out, you need a broker who can manage money as well as he charms Grandma. Here are five questions to ask any broker before you hire him. If you don't get good answers, keep looking.

### 1. Is my account too small for your best broker?

"Everyone's interested in your money, and how much money you have dictates how interested they are," says Marshall Cobb, a financial adviser in Houston. "If you're the average investor and you've got $10,000 to $15,000, if you go to a major broker like Merrill Lynch or Morgan Stanley, they'll give you their least experienced broker." The really good brokers are managing accounts worth millions.

A Merrill spokesman acknowledges that small investors are directed to its telephone-based sales staff, called the Financial Advisory Center, rather than to local branches for face-to-face dealings with the best brokers. That's because, he says, small investors have "less sophisticated needs."

But if you are likely to get the cold shoulder from a Wall Street giant, you might get warm hugs from a smaller firm like A.G. Edwards and Edward Jones. Successful investors make money, which means they make money for their brokers. Some regional firms even send their brokers door to door, like insurance salesmen, building trust across the kitchen table.

### 2. How does the broker get paid?

There are commissions, and then there are commissions. It's illegal for brokerage firms to offer special incentives for their brokers to sell their own brand of funds, but they manage to do it with such ruses as "ticket fees" charged on other companies' funds. "Preferred" fund companies also sponsor branch golf tournaments, buy the whole office lunch and distribute other goodies that predispose brokers to push business their way. Edward Jones was rapped by regulators over its preferred relationships.

---

**Related news and commentary on MSN Money**


- 8 ways to check for 401(k) plan abuse
- Own a piece of China's Google wannabe
- No more China on the cheap
- StockScouter stays strong with energy, housing
- Sign of trouble: A BlackBerry with your pizza
- MSN Money's 401(k) Quick Check tool

---

Also, firms that can lock your money up for a long time make the most money of all. A fund's B class of shares pays brokers the highest commissions -- because investors pay a penalty if they sell the shares within seven years or so.

"In my opinion, selling a client a B share is the worst thing a broker can do," says Roger Wohlner, an adviser with Asset Strategy Consultants in Arlington Heights, Ill.

**3. How does the broker invest?**

You want somebody helping you who shares your values and goals. Call on prospective brokers in person and query them about the kinds of funds they use to meet such everyday goals as retirement and saving for college.

Ask for specifics. Be wary if he recommends the brokerage's own funds, unless they are truly superior to funds offered by independent investment managers like American Funds, Franklin Templeton and MFS.

Ask about those "preferred" fund families. Nearly every brokerage has them. The fund companies kick back a percentage of fees on all client money the brokerage invests in the funds.

Brokers also "still get what they call due diligence trips with preferred fund families in the Bahamas and San Diego -- all the warm-weather places," says Dennis N. Houlihan, an investment adviser in Fort Wayne, Ind. "Obviously, there's that dangling carrot there. You only get invited if you're meeting sales quotas."

### 4. Do you get a break(point)?

When working with a broker, it pays to keep your money with one or two fund companies. Break points are commission discounts for substantial investments with the same fund company. **Franklin Income Fund** (FKINX), among the best funds of its type, has a load, or sales commission, of 4.25% on its A class of shares. But if you meet certain minimums, you get lower charges:

| How Franklin Income Fund A commissions change | |
|---|---|
| Amount of purchase | Commission |
| Less than $100,000 | 4.25% |
| $100,000 but less than $250,000 | 3.50% |
| $250,000 but less than $500,000 | 2.50% |
| $500,000 but less than $1,000,000 | 2% |

Source: Fund prospectus dated Feb. 1, 2005

At some fund companies, discounts begin with investments as low as $25,000. The minimum applies to the account, not to individual funds, so concentrating investments in a single fund company usually results in lower costs. In some cases, the minimum can apply to all accounts in the same household -- from IRAs to trusts.

The breakpoints are available on most companies A share class. That class of shares also typically carries much lower annual expenses. The expense ratio for the A shares of the Franklin fund is 0.68%, or $68 on a $10,000 investment. On the B shares, the charge is 1.53%, or $153. That's because B shares tack on an extra 0.75% to encourage brokers to sell them.

There can be legitimate reasons for using more than one firm: Some companies excel in managing bonds; others are great with stocks. But owning funds from more than two providers can be expensive to the degree you miss out on breakpoints.

### 5. Is the broker's record clean?

Paul N. Winter, a principal of Five Seasons Financial Planning in Holladay, Utah, notes that the NASD allows you to check the record of a brokerage firm or an individual broker for past run-ins with authorities. The site also has links to state securities regulators, who maintain their own compliance files.

What you're paying for when you buy a mutual fund from a broker is advice. Your common goal should be to maximize your investment returns within the boundaries of the risk you are willing to accept.

Good advice is worth a fair price. The ethical brokers will be straightforward in explaining how earns his living. Look for experience and integrity. Nearly everybody asks friends and associates for recommendations.

But don't put too much weight on them. Too many brokers' clients don't know enough about the business to realize they're being gouged. Now you've got an advantage over them.

*At the time of publication, Timothy Middleton didn't own any securities mentioned in this article.*

http://moneycentral.msn.com/content/P124475.asp