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Retirement Planning Insights

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Up Front

Summer's last hurrah (social distance style)

We recently took our last vacation of the summer. My family and I spent a few days in Cape May, NJ, which is the southernmost tip of the state. Cape May touts itself as one of the country's oldest vacation destinations.

We ate dinner one night at Congress Hall (pictured below), which was built in 1816 and claims to be America's oldest seaside hotel. Maybe it is, maybe it isn't. Either way, it's definitely a cool place.

New Jersey still prohibits any form of indoor dining. Thankfully, restaurants have been creative with offering outdoor dining. We ate with friends at tables on the front lawn of the hotel. The good news was that the weather was perfect (unlike the recent string of weeks where it was 90 degrees and humid every day). However, considering the lawn is only a few hundred feet from the ocean, there were plenty of hungry seagulls on the prowl. Our friends' son lost most of his grilled cheese to the flying rats. It could have been worse though – the table next to us involuntarily parted with a few of their cooked shrimp.

Unfortunately, cold weather will soon make outdoor dining increasingly less palatable. Furthermore, New Jersey may not open indoor dining any time soon. I fear for the thousands of mom and pop restaurants who likely won't be able to stay afloat until a COVID-19 vaccine is available and widely administered. Until then, please attempt to support your local restaurants and other small businesses in any way you can!

Summer 2020 was an unusual one, to say the least. Hopefully you were able to take lemons and make lemonade.

-Andy

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Retirement Planning News

Why asset-based advisory fees are bad

On August 24, InvestmentNews published an article, **Asset-based fee models are 'lazy' – and flawed.**

The article gets a bit technical and isn't specific to retirement planning. But it's a topic in which I have VERY strong feelings so I thought I'd share.

Many financial advisors charge based on the amount of assets they manage for clients. The most common method is to charge 1% of assets under management, or "AUM."

I don't have a favorable view of the percent of AUM model, as you'll see below in the "Practical Retirement Planning" section. Though I at least acknowledge that fee method kind of made sense in the past when investment management was a lot more work to do well.

Now, good investment management is becoming increasingly cheap, easy and commoditized. And as the article points out, clients and advisors alike are realizing the real value is not just investment management but in holistic financial planning (like cohesive advice on tax minimization, Social Security claiming, pension analysis, healthcare decisions, housing decisions, etc.)

It's always been my belief that the size of your assets is a poor gauge of the complexity of your financial life and therefore a poor gauge of your financial planning needs. Yet under a percent of AUM fee model, you'll PAY more simply because you HAVE more.

The article says, "Charging AUM is a fundamentally lazy way to charge… There's never been a profession where they charge you based on how much money you have." The article additionally says, "…it will get increasingly difficult for advisers to make the case for charging clients based on the size of their portfolios." I agree 100%!

In its defense, the percent of AUM model is easy to understand and implement. But that doesn't mean it's the best…or fair.

Practical Retirement Planning

Understanding advisor compensation methods

There are ultimately four different financial advisory fee models:

Commissions – In my opinion, this is the most tainted of the models and is typically the compensation method for insurance salespeople and securities brokers who masquerade as advisors. You generally don't *directly* pay the salespeople for their services. Instead, they get paid a commission from the company whose product they sell to you. If they're paid solely from selling you something, you can imagine how their "advice" will almost certainly end up being a recommendation to buy something they peddle. Is that the type of advice you want???

Percent of Assets – Otherwise known as percent of assets under management, or "AUM." This is probably the most common fee method. Under this model, advisors typically charge around 1% per year of the assets they manage for you. Advocates of this form of compensation boast their interests are aligned with yours because they only do better when you (i.e. your investments) do better. In other words, if your accounts go up in value, they make more, and vice versa. But the inherent flaw with this model is that it often overcharges you if you have accumulated a sizable amount of assets. I'll let you in on a little secret - it's rarely twice as much work to advise a client who has $2,000,000 than it is to advise a client who has $1,000,000. Yet under the percent of AUM model, the first client would pay twice as much as the second client.

The other flaw of this model is that advisors are more likely to make recommendations that involve keeping your assets with them. Picture this scenario - you ask your advisor if it would be a good idea to take $300,000 out of your account to pay off your mortgage or buy a vacation home. At 1% of AUM, the advisor would lose $3,000 per year of recurring revenue from you if that money were to leave your account. Do you think that advisor can give you a truly unbiased answer???

Flat Fee – Also known as a “Retainer” or “Subscription.” The fee is generally fixed and is agreed upon prior to entering a relationship with the advisor. You may have the option to pay on a monthly, quarterly or annual basis. The fee is typically based on the complexity of your financial life and therefore the amount of service and resources necessary in providing you ongoing advice. Some advisors charge a flat fee for financial planning services and separately charge a percent of AUM fee for investment management. Other advisors (such as yours truly) charge a flat fee that includes both financial planning AND investment management. This compensation structure is rare but becoming more popular.

Hourly – As the name implies, some advisors charge hourly for their time and advice. This model doesn’t lend itself well to investment management or ongoing financial planning as the hours will really start to add up during the course of the year. But if you have some very specific questions whose answers won’t depend on a broader analysis of your whole financial picture, a little bit of hourly advice here and there may be all you need. Most advisors don’t offer their services on an hourly basis but there are nonetheless some who do (again, yours truly is one of them).

To be fair, no fee structure is perfect or completely free from potential conflicts of interest. However, in my opinion, flat fee is the fairest method for ongoing investment management and/or financial planning relationships. For one-off financial questions, the hourly structure is obviously the best.

I think it was Warren Buffet who said, “price is what you pay, value is what you get.” In other words, regardless what fee structure your advisor has, make sure you feel like you’re getting enough value for what you’re paying. The fee itself isn’t necessarily what matters…it’s what you get for that fee. But some fee methods make a lot more sense than others!

If you’d like to learn more about our services and fee structures, check out the **Services & Fees** section of our website.