Six Mistakes To Avoid

When Selecting A New Financial Advisor

This is your life savings we are talking about and we believe it's wise to do a little homework! The financial services industry is filled with skilled salespeople who do not guarantee to put your interests ahead of their own.

So, if you are evaluating your financial advisor by how friendly they are, how nice their office is, or how good they make you feel, maybe its time to **dig a little deeper**.

Mistake #1

Underestimating The "F" Word

What would your relationship with an advisor look like if they were legally compelled to be a fiduciary for you?

Ask your advisor to sign a fiduciary pledge!

Fiduciary: **A person who holds a legal or ethical relationship of trust with one or more other parties. A fiduciary is required to handle investments in a disciplined and defensible manner.**

The financial services industry has a huge problem with hidden fees, self dealing, and other conflicts of interest. That problem has gotten serious to the point that the Department of Labor proposed new rules which would have required financial advisors to adopt a **fiduciary** standard.

Not surprisingly, many in the industry fought this.

Mistake #2

Failure to understand how the advisor gets paid

Suitability Standard vs. Fiduciary Standard

Let's say you come to your advisor for advice on how to invest a new sum of money. There might be 2 investment options that are technically appropriate for you.

But what if the only difference between those 2 options is cost?
What if one option paid your advisor a big commission and the other one did not?
Would you expect that information to be disclosed?
If the return is the same and cost is the only differentiator,
you can't expect the advisor to recommend the product with the lower commission.

Under the suitability standard, the need to disclose potential conflicts of interest is not as strict a requirement for brokers. An investment must only be **suitable**; it doesn't necessarily have to be consistent with clients' objectives and profiles. Whereas a **fiduciary** standard requires conflicts of interest and total cost to be disclosed and the client's best interests must come before the advisor. That means recommending the lower cost option.

conflict of interest: **A situation in which a person is in a position to derive personal benefit from actions or decisions made in their official capacity.**

Does your prospective advisor accept perks from mutual fund or insurance companies? Examples include marketing money for client events, complementary due diligence trips to exotic locations, golf outings, meals, and tickets to sporting events.
It all comes back around to the recommendations an advisor makes for your money: What factors are influencing their decision?

Mistake #3

When it comes to advisors, it pays to be a stalker!

Does your potential advisor's website make it easy to learn about their firm or are they evasive?
If their website doesn't impress you, what are the chances their service will?

1. Seek information on how they are compensated.

2. Read about their credentials and educational background.

3. Visit brokercheck.org and find out where an advisor is registered, what credentials and licenses they hold, and if there are any complaints or arbitration against them.

Focusing On The Wrong Character Traits

Mistake #4

Find an advisor with the heart of a teacher.

And the heart of student, too!

Being an advisor is about more than following the stock market:

- An advisor's role is to understand the full range of investment products and how to match those with investor needs, risk tolerance, and desire.
- It's about communication skills and being able to act as a teacher, as a coach, and sometimes even a therapist.
- Don't forget the need to keep up with the latest in legal and regulatory changes.

The best professionals are always reading, learning, and seeking to be the best for their clients and their business.

Paladin Research analyzed 205 financial certifications, designations, and accreditations that advisors are using to demonstrate expertise in their field. According to their findings:

37% of designations were rated LOW quality

No prerequisites, no curriculum, no testing, minimal continuing education

Imagine that! Letters after your name without any study or testing; just write a check!

51% of designations were rated MEDIOCRE quality

No significant prerequisites or curriculums, self-study and open-book tests are allowed

Would you see a doctor who was allowed open-book testing in medical school?

12% of designations were rated HIGH quality

Prerequisites, curriculum, timed/proctored examinations, 30+ hours of continuing education

Examples: CMT Chartered Market Technician, CFA Chartered Financial Analyst, CFP Certified Financial Planner, and CIMA Certified Investment Management Analyst

Source: Waymire, Jack. "Beware of Financial Advisers With Bogus Credentials." *Next Avenue*, 12 Sept. 2012, www.nextavenue.org/beware-financial-advisers-bogus-credentials/.

Having a Narrow Mindset When Judging Performance

Mistake #5

Ask the average investor how they judge success or failure in their portfolio. What response might you receive? Probably a version of "If I'm making money, I'm happy!". **But how does your advisor really add value? Ask them what is their process?**

Risk Management

Ask your advisor what their risk management strategy is and how has it performed in the past?

There are 3 primary types:

- Traditional risk management with a bond portfolio
- Dividend Growth Stock Strategies
- Technical Analysis

Risk Scores/Rates of Return

- Do you know what your risk tolerance is?
- Is your portfolio tailored to your desired level of risk?
- Are your returns being measured against your desired rate of return to meet your goals?

Wealth Planning

- Forecasting returns, expenses, and income flows
- Setting personalized goals and objectives
- Monitoring inflation
- Insurance Analysis

There are two types of advisor compensation

Commission and fee. A fiduciary advisor should disclose payment information readily and declare if they are collecting commissions. It is becoming easier to make financial recommendations that do not require commission products, so why are they still being employed? This affects your bottom line as an investor. True, Fee advice isn't necessarily better advice, and that's why ***credentials and transparency*** are critical.

Mistake #6

Not getting it in writing

Get Everything In Writing

Learn to ask the right questions: What is the total cost of doing business with an advisor? Do you accept revenue sharing? Do you have a fiduciary pledge?

Remember President Reagan's famous dictum:

"Trust, but Verify"

Large investment companies often charge behind the scenes fees to a mutual fund company before allowing them to access the firms sales force.

This is called "revenue sharing". Just like prime shelf space in the grocery store, mutual fund companies pay higher fees to get better visibility. They pay to get their products at the top of the recommendation list.

This cost is being passed on to the investor and is quietly driving up the cost to invest.

Your prospective advisor may lie to you about their compensation. Get their answers to these questions in writing, and then get a second opinion.

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