

11 SIGNS YOU ARE WORKING WITH THE WRONG FINANCIAL ADVISOR

- Have you asked your advisor to be more conservative and he or she fought you on it?
- Have you ever felt like your advisor doesn't put your interests ahead of theirs?
- Has your advisor suggested that the only way to grow your assets is by investing in the stock market?



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Find Out if It's Time to Break Up with Your Current Advisor!

11 Signs You Are Working with the Wrong Financial Advisor

Check any that you've noticed from your current financial advisor:

- Financial Advisor Doesn't Listen to Your Temperament:** Have you asked your advisor to be more conservative and he or she fought you on it?
- Self-Interest Morphs into Greed and Selfishness:** Have you ever felt like your advisor doesn't put your interests ahead of theirs? If so, it might be time to work with a fiduciary.
- Financial Advisor Sells Prefabricated, Prepackaged Products Instead of Actually Planning and Customizing Your Portfolio to Suit Your Needs.**
- Advisor Prefers Bond Mutual Funds Over Individual Bonds:** When you buy individual bonds, you're guaranteed a fixed rate of interest and guaranteed to get your principal back. Bond mutual funds don't pay a fixed rate of interest, and there's no guarantee you'll get your principal back.
- Advisor Is Part of a Large Franchise Where Their Professional Duty Seems to Conflict with the Demands of Their Organization:** Franchises work well when you're buying a sandwich or a pizza, but not so much when you're planning your financial future.
- Assets Under Management:** Advisor seems more interested in how much of your money you are willing to allow them to manage rather than understanding your investment needs.
- Mutual Funds – The Disease of Ease:** Advisor takes the easy way out and recommends mutual funds because it's easier than researching the actual holdings themselves.
- Stock Market Addiction:** Your advisor suggests that the only way to grow your assets is by investing in the stock market.
- Advisor Doesn't Understand Reverse Dollar-Cost Averaging and the Need to Generate Income:** Instead, they recommend that you liquidate shares of your investments to generate income, causing you to cannibalize the principal balance of your retirement savings.
- Wrapping Mutual Funds:** Financial advisor suggests using a wrap account to get professional-level portfolio management. This is just a fancy way to say they will be investing your money into a few different mutual funds. So, instead of paying the usual 0.25 or 0.50 percent fee for a mutual fund, you could end up paying 1 to 1.5 percent
- Variable Annuities – Additional Hidden Fees:** Variable Annuities are an easy way to maintain all the risk of the market in the single most expensive way possible.

1. Financial Advisor Doesn't Listen to Your Temperament

Have you asked your advisor to be more conservative and he or she fought you on it? Could it be that the reason why some financial advisors don't listen to their clients when they want to move their assets into more conservative investments like bonds is commissions?

According to a recent article on Financial-Planning.com, "Financial advisors have a natural incentive to say no to opportunities that remove capital from the portfolios they are managing. It's an unspoken conflict of interest that gets very little attention—the more clients remove money from their portfolios, the more it reduces compensation...this is short-term thinking that will ultimately backfire."¹

2. Self-Interest Morphs into Greed and Selfishness

Have you ever felt like your advisor doesn't put your interests ahead of theirs? If so, it might be time to work with a fiduciary.

Certified financial planners and registered investment advisors take a pledge to put their clients' interests ahead of their own. This is known as acting as a fiduciary. Traditional stockbrokers aren't held to the same standard, even if they've given themselves the title of "financial advisor."

A fiduciary is a person who holds a legal or ethical relationship of trust with one or more parties. Typically, a fiduciary prudently takes care of money or other assets for another person.

In February 2017, President Trump signed an executive order directing the Department of Labor to review and potentially rescind the fiduciary rule that requires financial advisors to act in the best interests of their clients. This rule basically required financial advisors and stock brokers to put the interests of their clients above their own when working with retirement accounts – much like lawyers and doctors do.

On June 14, 2018, Barrons.com announced that the Department of Labor’s Fiduciary Rule was “Officially Dead,” marking the end of the rule, which was crafted by the Obama administration.²

Instead, the Securities and Exchange Commission has proposed its “Best Interest Rule” that could end up replacing the Department of Labor’s Fiduciary Rule for brokers and financial advisors.

The Wall Street Journal reported:

The SEC’s plan to require brokers to act in the best interest of clients is less restrictive than the “fiduciary rule” affecting retirement accounts...The SEC’s rule would not ban any single conflict of interest, such as sales contests that brokers conduct to juice sales of particular products but would generally require brokers to disclose conflicts of interest and try to blunt their impact.³

So, as of now, if you are working with a financial advisor who is a registered broker, he or she is only obligated to recommend investments that are “suitable” for you. This means that if your advisor has a choice between two similar mutual funds, but one pays a higher commission, the advisor could recommend the one that pays them a higher commission—even if the other fund has lower fees and might be better for your portfolio over the long-term.

The Trump administration says the reason it wants to keep this system in place is that it believes the fiduciary rule limited the investment choices for clients and burdened the financial industry with “unnecessary” regulations.

The good news is that registered investment advisory firms are still required to act as fiduciaries. This is quite different from broker-dealers and representatives who provide investment recommendations for a commission. Broker-dealers and their representatives are not required to act as fiduciaries. They are only required to make “suitable” recommendations. Could the reason the broker finds that investment “suitable” for you be that their firm is running a contest that offers a vacation to the Caribbean to those who sell the most of that product that week?

3. Financial Advisor Sells Prefabricated, Prepackaged Products Instead of Actually Planning and Customizing Your Portfolio to Suit Your Needs

What’s important here is to understand how stockbrokers, financial advisors, and registered investment advisors get paid. Registered investment advisors are compensated on a “Fee-only” basis. A big benefit to hiring a registered investment advisor is that they have no financial incentive to recommend a “prepackaged” product. They recommend what they feel is in your best interest.⁴

On the other hand, many brokers and advisors are compensated on a commission-only basis. This means they make money by selling “prefabricated” financial service products like stock mutual funds or bond mutual funds. These advisors often work for large franchise-type companies.⁴

Another type of compensation structure is known as “commission and fees.” Commission and fee-based advisors might receive a fee for punching your information into their computer to generate a financial plan for you and then will collect a commission when they sell you that prepackaged investment product.⁴

You can avoid having to wonder why your advisor is recommending certain products by working with a registered investment advisor.

4. Advisor Prefers Bond Mutual Funds Over Individual Bonds

Since many of today's advisors got into the business during the '80s or '90s in what was the best stock market in U.S. history, most have become stock market specialists. Frankly, if they do fixed income, it's usually an afterthought. Most will simply take the easy way out and invest their clients' money in bond mutual funds.

What many people don't realize is that bond mutual funds carry risks and tax implications that can be reduced and even eliminated by investing in a diversified portfolio of individual bonds or other fixed-income securities.

When an investor buys an individual bond, they're guaranteed a fixed rate of interest for the life of the bond, and when the bond matures, they're guaranteed to get their principal back—assuming there've been no defaults. So how, then, do bond mutual funds compare to individual bonds?

Bond mutual funds do not pay a fixed rate of interest. The interest they pay fluctuates. Also, bond mutual funds don't mature; they go on until you decide to liquidate them. So, both guarantees that are inherent in individual bonds are “off the table” with bond mutual funds.

5. Advisor Is Part of a Large Franchise Where Their Professional Duty Seems to Conflict with the Demands of Their Organization

Franchises work well when you're buying a sandwich or a pizza, but not so much when you're planning your financial future.

Let's refer to the same article from Financial-Planning.com that we referred to in item #1 of this report. Here's a quote from the author of that article who used to work for one of these franchise-type financial services companies:

Years ago, when I worked as a financial advisor at a major brokerage firm, we learned highly sophisticated ways to analyze clients' investment ideas so we could consistently tell them 'no.'

I recall the time my client wanted to invest in a promising real estate project in his hometown. I sent it to my firm's real estate department for review. I also shared the opportunity with my manager. Ultimately, we wound up pitching the client on investing the firm's upcoming private real estate fund and passing

in the local project. At the time, I was a young advisor and did not know any better. I really believed the firm's experts had a much higher likelihood of producing a successful real estate project than the

local team in the client's backyard. And then 2008 came. Some of the smartest investors in the world got caught with their pants down. There was carnage in every asset in the world, including the private real estate fund I convinced the client to choose over the local opportunity. The leverage taken out by the fund wiped out more than 50% of the fund's net asset value.¹

Although this young financial advisor had the best intentions, the demands of the large financial institution he worked for ended up causing him to recommend his firm's own fund that ended up costing his client dearly. The lesson here? When it comes to trusting someone to help you plan your financial future, you would be better served dealing with someone who is willing to take the time to customize a financial plan that put your interests and financial well-being ahead of theirs.

6. Assets Under Management

The advisor seems more interested in how much of your money you are willing to allow them to manage rather than understanding your investment needs.

Assets under management (AUM) is the market value of the assets a financial institution manages on behalf of investors. Why does AUM matter to an investment company? Well, investment companies use AUM as a marketing tool to attract new investors. Basically, the more assets they can claim to have under management, the more successful they appear to be compared to their competition.

For investors, AUM can be an important consideration when it comes to the fees they are charged. Prepackaged investment products can charge management fees that are calculated as a fixed percentage of total assets under management. Financial advisors can also charge their clients fees that are based on total assets under management.

7. Mutual Funds – The Disease of Ease

The advisor takes the easy way out and recommends mutual funds because it's easier than researching the actual holdings themselves.

Instead of spending the time to research individual securities and run the risk of choosing the wrong stock or bond, many advisors will simply advise you to place your money in a mutual fund to give you instant diversification. This way, if the fund performs poorly, they can point the finger at the fund manager.

Unfortunately, the simplicity and convenience that stock and bond mutual funds provide advisors come with additional costs and risks to investors.

We already discussed the fact that when an investor buys an individual bond, they're guaranteed a fixed rate of interest for the life of the bond, and when the bond matures, they're guaranteed to get their principal back. Unfortunately, with bond mutual funds, these guarantees do not exist. There is no guaranteed rate of interest, and most importantly, there's no guarantee you will get your principal back.

With stock mutual funds, one of the biggest risks is market volatility. And, we have certainly had our fair share of volatility so far this year. As we mentioned earlier, with bond mutual funds, there's no guarantee that you'll get your principal back, and this is certainly true with stock mutual funds. If the market happens to experience a major downturn, it's likely that your investment in the mutual fund will also experience a major loss.

Something else that you need to be aware of when considering mutual funds is liquidity risk. This is the risk involved with how easy or difficult it can be to get out of your investment. If the market happens to experience a major downturn, there might not be a buyer available who is willing to buy your shares of that investment while the market is going down. This means that you might have to ride out some losses while you wait for someone that is willing to purchase your shares of the fund.

Finally, another big reason why investing in a mutual fund might not be in your best interest is the high cost associated with them. The fee structure of most mutual funds can be very complex but, in the end, these fees can end up eating away at the gains the fund manages to earn.

8. Stock Market Addiction

Your advisor suggests that the only way to grow your assets is by investing in the stock market.

Did you know that for many years, investing in stocks was considered too risky for the pension fund portfolios of many cities, states, and countries? It was considered so risky that it was expressly prohibited in most cases. Instead, municipalities had a list of acceptable investments. The list varied from state to state, but it was usually made up of fixed-income investments such as government bonds and high-quality corporate bonds.⁵

So, if it was considered too risky for the portfolios of many cities, states, and countries for so long, why do so many financial advisors still recommend them for those who are close to retirement age? Could it be because that's what they know best? As we mentioned earlier, since many of today's advisors got into the business during the '80s or '90s in what was the best stock market in U.S. history, most have become stock market specialists and do not possess the specialized knowledge of fixed-income securities required to manage them properly. Instead, most will just take the easy way out and recommend that you invest in bond mutual funds.

9. Advisor Doesn't Understand Reverse Dollar-Cost Averaging and the Need to Generate Income

Instead, they recommend that you liquidate shares of your investments to generate income, causing you to cannibalize your retirement savings.

The purpose of dollar-cost averaging is to get the average cost of your purchase price down so you can buy low and sell high, which is the cornerstone principle of smart investing. This strategy works well when you're in the contribution stage of retirement investing. The problem arises when you reach the point where you're not saving into your fund anymore, and you start drawing funds from your principal balance to satisfy things like IRS Required Minimum Distributions. The same principles apply but in the opposite direction. You are now making one of the biggest mistakes a retiree can make—the mistake of reverse dollar-cost averaging.

To understand the potential danger of spending down on principal, let's consider a 30-year retirement like a 30-year mortgage in reverse. When you first start making mortgage payments, you're not paying back much principal at all. Instead, you're paying primarily interest and only a small amount of principal. As the years go on and the balance gets paid down, you pay a little less interest and a little more principal. The process continues until, after 30 years, your mortgage is paid off.

Now, let's imagine the same process in reverse. Take a pool of savings worth \$1 million, generating 5 percent interest per year, or \$50,000. If you take even just a little bit more than the \$50,000 each year, just a small amount of your original principal, your \$1 million in savings will be depleted within 30 years in much the same way that a mortgage is paid off.

If you are retired and still invested in mutual funds during a downturn in the market, it can be even worse than the 30-year mortgage. That's because you'll have to sell more shares of your mutual fund to generate the income needed to pay the bills.

10. Wrapping Mutual Funds

The financial advisor suggests using a wrap account to get professional-level portfolio management. This is just a fancy way to say they will be investing your money into a few different mutual funds. (More Fees)

A mutual fund wrap, or wrap account, is basically a prepackaged portfolio of mutual funds that target different styles of investing such as income or growth. These types of accounts are usually offered by full-service brokerage firms. Investors can choose from a selected list of pre-packaged mutual funds. Investors pay an annual fee for the account, which is known as a wrap fee.

In a situation where a broker recommends wrapping mutual funds, the broker is subcontracting the responsibility of monitoring and researching your investments to the managers of these funds. What ends up happening is that instead of paying the usual 0.25 or 0.50 percent fee for a mutual fund, you will end up paying something around 1.0–1.5 percent in fees. In essence, your broker is charging you 2 to 3 times the normal commission but is actually doing less work managing your investment. A good deal for the broker, not so good for you.

11. Variable Annuities – Additional Hidden Fees

Variable annuities are an easy way to maintain all the risk of the market in the single most expensive way possible.

An article that appeared on Forbes.com titled “9 Reasons You Need to Avoid Variable Annuities” described why many financial advisors and personal finance “gurus” despise variable annuities. One of the top reasons is the high fees associated with them—anywhere from 2%–4% per year. Investment options are typically very limited and often have high expense ratios.

Variable annuities typically lack liquidity and can tie up your money for long periods of time. If an emergency comes up and you need to access your money, you will be hit with surrender penalties.

There are some rare occasions when a variable annuity makes sense, such as a doctor who wants to protect his or her assets from malpractice suits or creditors. There are a few other situations where variable annuities might make sense, but they are very few and far between. Usually, variable annuities tend to favor the bank account of the advisor or broker selling them.

Here's what Suze Orman had to say about variable annuities:

“I hate variable annuities with a passion...especially variable annuities that are used in retirement accounts... I think variable annuities were created...for one reason only...to make the financial advisor selling you those variable annuities money.”⁶

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