Wealth Management

# Tough Questions to Ask an Investment Advisor

When selecting a trusted advisor, most people want a guideline for analysis of their potential choices. The following questions are designed to provide guidance for individuals and families who want to select the best possible advisor at reasonable costs. ASI Wealth Management suggests that the following questions will help you select an advisor that will serve your best interests.

## 1 Is your advisor independent and totally objective?

- Does the advisor or advisor have a brokerage or insurance company affiliation?
- Does the advisor or advisor collect revenues from product providers, such as 12b-1 trailing commissions, front-end loads or commissions, or commissions generated on trades of one fund or manager versus another?
- Does the advisor receive other remuneration from product purveyors such as soft dollars? Bonuses? Trips? Directed trades? Marketing assistance?

Firms that have an affiliation with brokerage or insurance companies create conflicts of interest in that they have incentive, either monetary or otherwise, to recommend products to you. A brokerage relationship enables an advisor to collect undisclosed fees and monetary rewards paid by mutual funds and other investment products. And as long as an advisor has additional incentive to sell or promote some products how do you know for sure that you are getting the best objective advice?

## 2 Does your advisor have the background, experience and education to deal with the complexities of your situation?

- How long has your advisor been in the industry and in what capacities?
- What professional designations does your advisor have?
- Who will be your key contact at the advisory firm or will you be working with a team?

While there is no guarantee that an advisor with an outstanding resume of credentials will give you good advice, verifying that an advisor has the appropriate training and experience does provide some indication of quality. There are several industry designations and certifications that lend credibility to an advisor, such as Certified Investment Management Analyst (CIMA), Certified Financial Planner (CFP), Certified Public Accountant (CPA), Certified Financial Analyst (CFA), or Accredited Investment Fiduciary Auditor (AIFA). An investment firm whose professionals offer combined experiences in a wide variety of investment situations will be better equipped to provide unique insights and creative solutions, and bring value to you.

## 3 Does your advisor's client profile and expertise match your needs?

- How large is the client base of the advisory firm? How many clients does your advisor consult?
- How many clients have they added or lost in the last two years?
- What is the typical size of the advisor's average client account?
- Request that the advisor provide a list of client references with phone numbers.

Ideally, your advisor will be sophisticated enough to handle your unique investment challenges and yet detailed enough to pay attention to your smallest needs. It is important to check the references of the advisor with a variety of clients, new clients, as well as, long term clients. It will be important to ascertain if the references have similar needs to yours.

## 4 What is the process for manager selection and evaluation?

- What is the process and criteria used in selecting investment managers?
- What is the cost factor and is it relevant to the performance of the manager or fund?
- How does the advisor assess qualitative aspects of the manager or organization?
- What types of analytical resources does the firm utilize?

An advisor's process for the search and selection of investment managers should be clearly articulated and understandable by everyone. Ask the advisor to describe the search process and the characteristics they look for in selecting successful managers. The process should be disciplined and, while it may contain both objective and subjective elements, the advisor should remain unbiased and unprejudiced by existing relationships, gifts, soft dollars or other forms of compensation.

Quantitative analysis plays a significant role in the evaluation of investment managers and the advisor should be well versed in statistical analysis. But, numbers only tell part of the story. Understanding the personalities of managers and the cultures of the organizations that surround them are significant factors in determining the potential for an investment manager to continue succeeding. Money managers and mutual funds often evolve through several life cycle phases and understanding where a manager is in this cycle can be an important ingredient in judging their ability to add value.

## 5 Does the advisor make final recommendations? Are they willing to be a co-fiduciary?

Many advisors provide you with more than one recommended solution and leave the ultimate decision up to you, thus removing them from liability, or so they believe. You're paying for advice, you should be sure to get it. An advisor who is willing to take responsibility as a co-fiduciary and work in tandem with you towards your goals will better serve you. Some advisors, such as stockbrokers, may be unable to accept fiduciary responsibility. Are you aware that the NASD regulations governing brokers require that their fiduciary loyalty be directed to the brokerage firm and not to the client?

## 6 Are all expenses disclosed? What is the fee arrangement?

- Does the advisor disclose all fees?
  - Finders' fees, Transfer agent (TA), or Sub-TA fees
  - Commissions
  - Gifts
  - Trips
  - Marketing assistance from vendors or managers
- Will the advisor perform an annual fee audit explaining where and to whom all the money goes and is there an extra charge for this?
- Is the advisor's fee all-inclusive or are there separate costs for separate services?

Fees should have a direct relationship to the time, effort, expertise, and experience that an advisor brings to the equation. Evaluate written fee proposals with a look at potential conflicts of interest that may exist. Advisors who charge separate fees for individual services such as manager search or writing an Investment Policy Statement, can be subjective motivated to find reasons to perform these billable services. An advisor who proposes a single fee incorporating all services may be in the best position to provide unbiased advice.

## 7 Does the advisor provide ongoing and consistent performance monitoring?

- How frequently does the advisor provide this information?
- Do they report performance on a net basis after all expenses?
- Are they willing to create meaningful custom benchmarks to compare account performance? If not, what benchmarks do they use and how long have they been using them?
- Do they also provide peer universe comparisons?
- Ask to see a sample of their reports.
- Do they have capability to make reports available online?

A good advisor will keep you informed, at a minimum, on a quarterly basis. Their reports will be easy to read and should show you how you're doing both in terms of percentages and in dollars earned. Your results should be evaluated after all fees and expenses, including the advisors.

When it comes to performance, your advisor should show you how each of your chosen managers has performed as well as how the overall portfolio is performing. Benchmarking is the critical process of setting a standard for comparison. Subjective selection of benchmarks can make any manager look good or bad. For example, some small cap growth managers compare their performance to the S&P 500 Index, which is comprised of large company stocks. Since riskier small stocks have historically outperformed large companies by a significant margin, the choice of this benchmark can make a manager look much better than they really are.

One of the most useful comparisons can be to a peer group of managers with the same objectives. Peer group comparisons can demonstrate how a manager's performance compares to his competitors, however, the makeup of the universe is important. If a manager is in the top quartile of a universe of 15 funds or managers, this is not as meaningful as if the universe contains 1000 funds or managers with similar objectives.