# TEN WARNING SIGNS OF WORKING WITH THE WRONG FINANCIAL ADVISOR

Poole Locke Associates

*Retirement Income Source®*

# Ten Warning Signs of Working with the Wrong Financial Advisor

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Are you working with the wrong financial advisor? Is he still the advisor best qualified to help you meet your retirement goals—and to do so with confidence and peace of mind? It's a crucial question, so we've compiled a list of "10 Signs You Might Be Working with the Wrong Financial Advisor" to help you decide.

## 1. Your advisor ignores your changing temperament

Have you asked your advisor to make your portfolio more conservative only to have him or her fight you on it? This is a major red flag. Most people want to invest more conservatively as they get older, and understandably so. If your advisor is pushing back, it could be because he isn't qualified to manage a truly conservative, income-generating portfolio—or it could be because he has a financial incentive to keep your portfolio the way it is.

## 2. Your advisor isn't a fiduciary

To expand on the point above, have you ever felt as though your advisor doesn't put your interests ahead of his own? If so, it might be time to work with a fiduciary. A fiduciary is held to the highest regulatory standards of professionalism and accountability and is legally obligated to always put his clients' interests first.[1] While all advisors are subject to regulatory rules and guidelines, not all are held to the standard of a fiduciary.

## 3. Your advisor uses prefabricated, or "cookie-cutter" strategies rather than customized portfolios

Many brokers and advisors are compensated on a commission-only basis, which means they make money by selling "prefabricated" financial service products like stock mutual funds or bond mutual funds. These advisors often work for large, well-known companies. Some other advisors might receive a fee for punching your information into a computer to generate a "cookie-cutter" type financial plan for you—one that includes a prefabricated product, for which they will also collect a commission.[2]

By contrast, an advisor who specializes in retirement income typically has no financial incentive to recommend a prefabricated product, nor does he believe in using computer-generated "cookie-cutter" strategies. His specialty is working with each client to help create a customized portfolio geared toward the client's situation, goals, and risk tolerance level.

## 4. Your advisor uses bond mutual funds

Since many of today's advisors got into the business in the '80s or '90s, during the best stock market in U.S. history, they remain "stuck in the 90s mentally", meaning they continue to specialize in growth-oriented stock strategies. 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 and bond-like instruments.

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 have been no defaults. 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. Your advisor is focused on assets under management

Another red flag is if your advisor seems more interested in how much of your money you are willing to allow him to manage rather than on 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 or advisor? Because they use AUM as a marketing tool to attract new investors. 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 pay. 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 AUM.

## 6. Your advisor has fallen prey to "the disease of ease"

Instead of taking the time to research individual securities, 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. This is what I call "the disease of ease."

We already mentioned 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 assuming there are no defaults. But with bond mutual funds, these guarantees do not exist. With stock mutual funds, one of the biggest risks is market volatility. 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. In the end, these fees can end up eating away at any gains the fund manages to earn.

## 7. Your advisor is addicted to capital gains

Did you know that for many years, investing for growth or capital gains in the stock market 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.[3]

So, if investing in growth stocks and mutual funds 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? Part of the answer may be that most aren't qualified to manage a stock market portfolio geared toward dividends rather than growth, which can help reduce your risk and allow you to grow your equity portfolio more strategically as you near and enter retirement.

## 8. Your advisor doesn't understand the risks of "reverse dollar-cost averaging"

As most investors know, 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 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 your Required Minimum Distributions. In this case, the same principles can apply but in the opposite direction. In other words, you end up buying high and selling low — the opposite of smart investing. This is reverse dollar-cost averaging, and it is one of the most common and costly mistakes retirees make with their money.

## 9. Your advisor suggests a mutual fund wrap

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 often 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% to 1.5% in fees. In essence, your broker is charging you two to three times the normal commission but is doing less work managing your investment. A good deal for the broker, but not so good for you.

## 10. He uses variable annuities

Variable annuities are an easy way to maintain all the risks of the market in the single most expensive way possible. An article 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% to 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. If an emergency comes up and you need to access your money, you will be hit with surrender penalties. 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.[4]

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