Choosing Your Investment Advisor

Content
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Choosing Your Investment Advisor

Choosing the “right” investment advisor can be a daunting task. You may be choosing an advisor for the first time. Or, although you currently have an advisor, you may want to review how you work and communicate with that advisor. Whatever the case may be, choosing an investment advisor you trust is a challenge and requires a certain amount of thought. In this report, we will discuss the steps you can take to find an advisor who best suits your unique situation.

Twelve questions to ask yourself

The first step in the process of either selecting an advisor or evaluating your relationship with your current advisor is to understand precisely what you are looking for in an advisor. Below are 12 questions you may ask yourself as you start either the selection or evaluation process. The goal of these questions is to assess what type of advisor is most suited to your particular preferences.

1. Do I want someone to craft an overall investment plan for me?
2. In addition to crafting a plan, do I also want someone to execute that plan?
3. Do I want to execute the plan myself?
4. Do I simply want someone to bounce ideas off of from time to time?
5. Do I want to execute the plan myself, but need someone to provide me with a steady flow of proactive ideas?
6. Do I want someone to help keep me disciplined to my overall investment plan?
7. Do I just want to turn over my investments to someone else and have them do it all, keeping me updated periodically on how my investment portfolio is tracking to my plan?
8. Am I the kind of person who will not be able to give up day-to-day control of my investment decisions?
9. Am I interested in and want to learn more about investments?
10. Am I disinterested in investments to the point where I don’t really want to manage the plan myself?
11. Am I interested in investments, but just don’t have the time to do it myself?
12. How do I want to compensate my advisor?
   a. Commission on every trade?
   b. Fees on assets managed?
   c. Hourly advice charges?

The table below maps the answers to your questions about your investment preferences, the type of advisor with whom you should be working, and guidance on where to start when you are trying to identify suitable candidates.

Once you have answered these questions and understand what you truly want in an advisor, you can either begin your search or be in a better position to evaluate whether your current advisor is the best fit for your needs. Whether you are looking for an advisor for the first time or considering changing your advisor based on a re-evaluation of your needs, we suggest compiling a list of several potential candidates and interviewing each one to make sure that their approach matches yours and that their personality is complementary to yours.
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Checking credentials
The next step in the process is to examine the credentialing, training, and experience of each advisor. An advisor’s credentials and training will relate to type of advisor he/she is. Certain credentials are easy to obtain and have no prerequisite for any actual investment experience, so it is important to understand what they are and which ones are most useful for the role you wish for your advisor. Ask the prospective advisor what each credential means, what the requirements are for obtaining it, and how rigorous the process was. You can also ask the advisor to provide you with a web site that offers more information on the credential to assist you with the due diligence process.

Types of advisors
Listed below are three general types of advisors, their respective credentials and the credential training requirements:

Certified Financial Planner. If you decide to use a financial planner, the preferred credential is the Certified Financial Planner (CFP®) designation. This designation is earned after the successful completion of financial planning coursework that often takes two or three years to complete, after which the advisor must pass a rigorous ten-hour exam. An advisor with the CFP® designation should be able to help you craft an overall financial and investment plan, but may or may not be someone you would use to manage your money.

Full-Service Broker. A broker typically holds a general securities registration achieved through coursework covering a variety of investment topics and regulations, and by passing a six-hour exam. Many brokers obtain additional registrations that extend to the supervision of other brokers, the use of options and futures, research report writing, and insurance. Those brokers who are interested in managing money in a fee-based environment often obtain the Certified Investment Management Analyst (CIMA®) designation, and those who become more active in the planning role earn the CFP® designation noted above.

Professional Money Manager. A money manager is often called a portfolio manager or investment manager and typically holds a Chartered Financial Analyst (CFA®) charter. To hold a CFA® designation, the individual must have at least four years of investment management or investment analysis experience, and pass three levels of examinations.

Doing your homework: narrowing down the list
Once you have narrowed the list of potential advisors to those who appear to have the credentials, training, and experience you prefer, then you should conduct thorough due diligence. Due diligence simply means doing your homework and background research on each of the candidates to be sure they have the experience, training, reputation, trustworthiness, and spotless record you are looking for.

Part of this process involves verifying that the advisors actually hold the credentials and registrations that they say they do and that their credentials or registrations are not under any review or suspension due to potentially improper conduct. To do this, you can check with the appropriate sponsoring organization—The Financial Industry Regulatory Authority (FINRA) for brokers, CFA Institute for CFAs, Investment Management Consultants Association for CIMAs, and Certified Financial Planner Board of Standards for CFP)—to inquire on those issues. If the firm is a registered investment advisor (generally firms managing more than $25 million in assets), you may ask the potential advisor for ‘Form ADV’. This form lists general information about the advisor, such as their education, employment history, services offered and fees charged. In addition, you should think about interviewing each advisor to see whether they are a good personality fit and whether there are any red flags that are likely to remove them from your list of potential candidates.

The “Look Elsewhere” factors
There are a number of red flags which may surface during the due diligence process that we call the “Look Elsewhere” factors. If you encounter any of the following red flags, cross the potential advisor off your list and continue the search elsewhere.

Chemistry and honesty. If the advisor you interview starts telling you what you should do before getting to know you and your situation, look elsewhere. If the advisor insists he/she has a foolproof system to beat the market and promises above market returns, look elsewhere. And, if an advisor “guarantees” anything, cross him/her off your list, and look elsewhere.

Number of clients and type of service provided. Potential advisors can give you a physical number of clients they serve, but you do not know for sure how accurate that number is. Ask for some references from his/her existing clients. Then call them and find out
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Exactly what kind of service, contact, and advice they receive. This information can help you determine whether the level of service offered is consistent with what you expect of an advisor. If it's not, cross him/her off your list, and continue to look elsewhere.

**How they get paid.** It is important to understand how the advisor gets paid for services. Is the advisor paid an annual fee or per transaction? Sometimes the advisor is paid a commission based on an investment return. Advisors do not work for free. If they imply that there is no charge for their services, cross them off the list and look elsewhere.

**Transition of existing portfolio.** One often overlooked issue when choosing an advisor is the care in which he/she transitions your existing portfolio to a recommended portfolio. Some advisors may want to sell off your existing portfolio right away so your money can be invested in different securities. Generally, restructuring a portion of your current portfolio may make sense, but it is important to consider tax implications, transaction costs and the exit fees charged for certain holdings. When all these factors are taken into consideration, you may find that it is more sensible to extend the transition process over multiple years. If you are getting pressured to sell your entire portfolio immediately, look for another advisor.

**Firm size.** The size of the advisor’s firm also can be an important factor to consider. Advisors associated with smaller firms may be limited in the types of investment products and services they can offer you, and may lack access to the wide range of idea flow available at a larger firm. Ask to see a list of investment options available to you as a potential client. It is important that the firm offer a blend of house—or proprietary—investment options as well as external—or non-proprietary—products.

**Firm type.** Some types of firms may have natural biases towards certain products or services. For example, advisors working for insurance firms tend to recommend insurance products while those working for mutual fund companies often recommend their firms’ proprietary funds. These may be very good investment options, but you want to make sure you understand why they are being recommended and how much the advisor is making from the recommendation.

**Firm focus.** You may want to consider how much experience the advisor has working with individual investors. Many firms focus on institutional clients and have little experience dealing with individual investors. This may become apparent in the advisor’s unwillingness to customize portfolios to each investor’s needs or the lack of consideration on the importance of taxes and the need to structure portfolios with tax efficiency in mind. It is also possible that advisors from institutional firms may not understand that individual investors are often more focused on down-side risk protection than institutional investors. If any of this seems to describe an advisor you are considering, look elsewhere.

**And finally making the choice**

Over time, we have seen that investors place a high degree of importance on three key factors when making decisions about an advisor:

1. A referral from a trusted source
2. The breadth of products and services offered
3. The firm’s reputation

Certainly, a referral from someone you trust or from someone you know at a firm that focuses on individual investors can be a great way to start your search for an investment advisor. However, you also should make sure there is chemistry between you and your advisor. You want an advisor you can get along with, but you also want one who will challenge you and not just agree with everything you say.
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