The High Cost of Bad Advice

In this article, we address why we believe the decision of hiring an advisor should not be based solely on fees. The quantity and quality of the services provided varies greatly from advisor to advisor.

When you interview potential advisors, you should look for the advisor who gives the best advice and is the best fit for you. The best advisors begin earning their fee from the day they are hired by helping you determine your most appropriate asset allocation, according to your unique ability, willingness and need to take risk. This is what we do with every single investor who becomes a client.

In determining your need to take risk, we will typically run retirement projections. This can be a particularly eye-opening experience if your portfolio is much more aggressive than needed.

However, many people believe all advisors using Dimensional Fund Advisor (DFA) funds (including those with very low fee schedules) will provide advice and service of equal quality. Investment advice is not a commodity. There is no free lunch. Hiring an investment advisor is an important decision, and all factors should be considered. We believe that high quality and high levels of service are typically accompanied by a fair price.

Examples of Bad Advice or Service

▲ Incorrect asset location — Academic evidence has shown that investors should locate their tax inefficient assets in tax-advantaged accounts. Many low-cost/low-service DFA providers use the same allocation for all accounts, regardless of whether they are taxable or tax-advantaged. This “model” structure is much easier for advisors to set up and maintain, but it costs you in taxes.

▲ Tax-loss harvesting — Many low-cost/low-service advisors will do tax-loss harvesting infrequently, if at all. Again, this makes portfolio management easier for the advisors but can cause you to pay more in taxes.

▲ Using too many funds — Advisors who slice asset classes too fine or use too many funds increase the costs of rebalancing. These costs do not show up in performance related marketing materials based on model portfolios, but they should not be ignored.

▲ Infrequent rebalancing — Low-cost/low-service advisors will often only check for rebalancing opportunities once per quarter, if even then. We use sensible tolerance ranges to determine when to bring the portfolio back to its intended risk/return profile.

The Value of Good Advice

When selecting an advisor, fees are an important consideration. However, you should also consider the services offered for those fees. Some value-added benefits we provide include:

▲ Executing and maintaining a portfolio tailored to your needs that fits your ability, willingness and need to take risk

▲ Rebalancing when the portfolio has moved outside of its tolerance ranges

▲ Offering separate account management for fixed income portfolios where this makes sense
▲ Providing risk management expertise (including long-term care, life insurance and property and casualty insurance)
▲ Integrating your investment plan with your estate plan
▲ Providing Roth conversion strategies and Social Security claiming strategies
▲ Offering advice on mortgage refinancing

We provide value for the fee we charge. Low-cost/low-service advisors likely provide little more than access to DFA for the fee they charge. Our firm devotes its resources to planning and creating solutions for the families it serves, rather than simply providing access to a fund family.

Making the Decision
When hiring an advisor, we strongly advise meeting the advisor in person. This is the best way to determine whether you can truly trust this person with your financial future. Many times, low-cost/low-service providers will only communicate via telephone and e-mail. Further, these advisors likely have 500 to 1,000 customers, making it nearly impossible for the advisor to have any type of personal relationship.

It is important to note that the costs of building a relationship are likely not the only area where they look to trim expenses. One example is technology. We have high-quality tools to help us look for rebalancing and tax-loss harvesting opportunities. Another key advantage we have is our affiliation with BAM Advisor Services. BAM is a service provider to independent Registered Investment Advisor firms. It has $10 billion under administration, which allows its member firms to benefit from economies of scale. Our clients see these benefits in the form of lower fees from custodians, access to key people at DFA and the intellectual capital we can access for unique client situations.

The key to making the decision is finding an advisor who you believe will give you the best advice and is the best fit for you. When making this decision, be sure to consider not only the fees advisors will charge but the services they will provide. While good advice doesn't have to be expensive, bad advice almost always costs you dearly.

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