McMurtry Investment Report™ Newsletter

Selecting the Right Financial Advisor May Change Your Life
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Consumers are continuously faced with a bevy of choices when choosing a financial advisor to help them with both their investments and their debts. How do they choose and what criteria do they use? Selecting the right advisor is one of the most important decisions they will ever make, so it is essential that they do their due diligence in this process.

For consumers well versed in financial matters, the decision is a lot easier. They already know what type of service they are looking for and can use their experience and knowledge to filter through the large list of financial providers to come up with a good fit. However, for most of us the task is a real burden. The situation is comparable to someone getting their car fixed without any mechanical knowledge.
Many clients no longer have defined benefit pension plans and are relying more on their own investments to provide them with their retirement income. They are getting more impatient on receiving poor investment performance, paying high fees, and an overall lack of receiving unbiased objective advice. In addition, they are discovering that their advisors are choosing inappropriate asset mixes based on their risk tolerance and age. They are also finding out that the principal component of their advisors' compensation is selling product and this has little to do with the advice or investment performance received.

Let's begin with a brief description of the types of financial providers that are available today in this country.

The first group that comes to mind for most of us are the chartered banks. They provide a multitude of services from basic bank lending and deposit taking facilities to financial planning and investment management. This group prides itself as the provider of everything financial. Their commercials suggest that there is no real need to go anywhere else for advice, which is inherently false and very misleading. They are mainly focused on selling their products with the financial advice provided lacking in substance and value. They may appear friendly and helpful acting like they are your best friend, but they may have a hidden agenda.

For example, after your periodic financial review with your banker, did you feel that they listened to exactly what you wanted or did you feel that they were continuously trying to offer you another bank account or credit card that you really do not need in the first place or that they were continuously trying to convince you to transfer your investments over from another provider?

If any of you have experienced these feelings, you are not alone. It is important at this point to reassess your needs and obtain a second opinion from a provider that more closely has your needs as their first priority and that offers you useful financial advice. The one positive factor is that mutual funds purchased at the bank branch level are normally not subject to redemption fees as is the case with full service brokers and financial planners.

Borrowing money for any reason, including mortgages, credit cards and lines of credit, is an onerous task for many of us. Obtaining several competitive quotes on renewing your mortgage is usually a good idea. It is true that this may negatively affect your credit rating with Equifax or Trans Union, but you still need to be prepared with what the marketplace is offering. Blind trust in your current provider only helps them, not you. They may tell you that there is really no need to get a second opinion. When you are shopping around for a mortgage, keep in mind that there are many other factors apart from just the interest rate that are important. Prepayment penalties can add up to a lot of money, so it is imperative that you ask a lot of questions.

Another factor is your credit rating. Normally your bank sends in a request to a rating agency when you apply for credit, unless you are restructuring your existing debt. The most important factor to keep in mind is that your bank has their own internal credit rating of you that frequently differs from the credit agencies. Their own internal rating is based on their criteria and can unfortunately be used against you when you need a loan the most.

For example, let's say you have an existing mortgage and line of credit with your home as collateral. When you want to renew your mortgage, you will have a problem if you or your spouse has recently just lost your job. Normally this is not an issue as long as the bank's internal credit rating of you remains satisfactory and you can renew your mortgage without completing a new credit application. But in many instances, the bank alters your credit rating making it impossible to renew your mortgage without a new credit agreement.

Completing a new credit agreement without proof of income may become a difficult task unless you have considerable assets and the bank is willing to make an exception to their credit rules. But for the most part, consumers are not aware of what a bank can do with your credit rating. The banks exert a lot of power and control over you that is not always readily apparent. It is very important to shop around as not all banks have exactly the same credit rules and some are more flexible than others.

When you are applying for a loan or a mortgage, don't forget the smaller quasi banks. These are less known mortgage providers that are sent mortgages principally through mortgage brokers. They are normally more flexible in terms of credit accessibility if you are a new immigrant to this country or are self-employed and not showing a lot of personal income outside your holding company. They are also more flexible for any consumer who has a lot of assets, but little income. Mortgage brokers traditionally will refer you to one of these providers instead of a bank. Do not be frightened away because you do not recognize their name. You may even obtain a better deal.

Financial Planners are another type of advisor that is available. Most of them are on 100% commission and are paid to sell their funds and / or insurance policies and products. While there are exceptions, their advisors predominately sell their clients load or deferred sales charge funds. Generally, any time a client wants access to their capital before seven years have elapsed, they incur a redemption fee that represents about 5.5% for the first two to three years and gradually tapers off to zero after seven years. Most firms offer an annual 10% redemption fee free option, but this service is only available once a year and is not cumulative if you do not use it. These firms tend to charge higher management fees on their funds, especially for their equity or stock ones. The combination of higher fees and the fact that your monies are normally not freely available without incurring a high redemption fee are factors that must be considered in any decision you make to go with a provider of this type.

Both full service and discount brokers represent another group of financial advisors. Many of these firms are owned by the banks, but there are some that are completely independent. Being able to invest in anything you like appears like shopping in a candy store. However, many customers invest in the latest hot stock, fund or exchange traded fund (ETF), without a lot of research. In fact. they frequently spend more time choosing their newest digital flat screen TV or buying a car. During my many years managing retail clients, I have frequently found investors with very specific industry or sector ETF funds that are very volatile and have little relation to the overall index. It is normally a safer bet just to purchase the overall index ETF or index fund of the TSX or S & P 500. Once you have this exposure, you can always tinker around the index by buying small positions in sector ETF's.

Personally, I manage my own family monies using a discount broker. But it is important to remember that I have been doing this for myself and clients for over thirty years. If you decide to invest your retirement funds yourself in individual securities through a discount broker, you should be very careful unless you have a lot of knowledge and experience.

However, you can always use a discount broker if your objective is to materially lower your overall management fees by purchasing index ETF's. Using market index exchange traded funds can sharply lower your fees from 2% for traditional equity funds to 0.25-0.50% for exchange traded ones. You can also do the same on the fixed income using ETF's. Establish a long term asset mix (% allocation of stocks, bonds and cash) for each account managed based on your specific risk tolerance, age and any tax considerations.

For example, put most of your stock exposure in Tax Free Savings and non-registered accounts with more of your fixed income in a tax sheltered RRSP. In addition, it is always a good idea to get your portfolio reviewed a few times a year by another advisor such as a full service broker or an investment counsellor to ensure that you are on the right track. It may cost you a onetime fee but it is worth getting an opinion from a professional. But it is important to keep in mind that full service brokers may not always be as objective with their advice as independent investment counsellors would be.

Many clients prefer to use a combination of a discount and full service broker or investment counsellor. In this way you pay for advice on part of your monies and save fees by investing the remainder with a discount broker. Full service brokers charge much higher fees than discount ones that may represent all commission or a combination of commission and a flat fee for assets managed. The principal difference between a full service and discount broker consists of the advice provided and the corresponding higher fees for this advice. Differing from the past, the compensation that full service brokers receive is based much more on the sales they generate as opposed to the investment decisions that they make for you. They are normally not paid a salary and are frequently paid to sell a product or service. In consequence their advice is not always in your best interest. Similar to financial planners, many full service brokers recommend only mutual funds that have redemption fees or DSC's.

Investment Counsellors are the last category that must be considered. There are two types - bank owned and independent ones. My preference is for the latter as they are not trying to sell you a bank product. The principals of these firms are usually all professionals and their sole objective is to see your net worth grow. Their fees are not based on commissions received, but represent a percentage of the assets managed. Their fees are normally about 0.75% lower than what a bank branch or financial planning mutual fund would charge. In addition, their fees are fully tax deductible for non-registered accounts, but not Tax Free Savings Accounts. This is not the case for mutual funds. You may be wondering why these companies do not command a greater share of the market. The only reason they do not is that these firms frequently have a minimum annual fee that is based on family assets of $400,000 plus.

In conclusion, I urge all of you to educate yourself to help you make better more informed decisions. This will lower the fees you pay and will greatly help to improve your investment performance and net worth.

Never let any advisor convince you into switching all your investments and borrowing requirements over to them without taking the time to review all your options.

Always obtain a second opinion. This will never hurt you in any way and you owe it to yourself to do this. Consider using a bank or quasi bank for only your borrowing needs.

Choose a separate company to manage your investments, preferably an independent investment counsellor or full service broker.

Use a discount broker if you have the knowledge and experience to pick individual stocks and bonds. You can still use a discount broker, even if you do not have a lot of experience, to purchase market index exchange traded funds for your stock and fixed income exposure. You will need to devote sufficient time for this important task. Set up an appropriate overall asset mix based on your risk tolerance and age, but use differing asset weights for each type of account to maximize the tax benefits.

Take pride in knowing that you are in the driver's seat, not the advisor.