



The Rise Of The Fee-Only Financial Advisor

By Jason Van Bergen

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The fee-only investment advisor is a newer type of investment professional who charges a flat hourly rate (or "a la carte" rate) for his or her services, instead of taking compensation from [commissions](#) on investment transactions. The fee-only advisor's services consist mainly of analyzing [portfolios](#) as a whole, so he or she is most likely schooled in many different asset classes, as well as other areas such as real estate, college financial aid, retirement and tax planning/preparation. Here we take a look at the fee-only investment advisor's place in the financial world and how this type of professional compares to those who are compensated by means of commissions.

Compensation and Efficiency

A common misperception is that financial advisors provide their services for free. Most investors give little thought to the hidden costs they pay when an advisor recommends stocks and later receives a commission when investors buy in, or when an expert [mutual fund](#) manager picks stocks for a fund that charges significant [management fees](#) or [front](#) or [rear loaded](#) payments. Consider this: making a \$50,000 investment in a fund with 5% load would translate into the equivalent of more than 14 hours of portfolio planning undertaken by a fee-only advisor at \$175 per hour! If you were to hire an advisor for 14 hours at that rate, you could expect him or her to accomplish a great deal of work that would produce a more balanced portfolio, returning a potentially higher rate than the loaded mutual fund. The fee-only type of compensation provides investors with the opportunity to get more service out of the money they spend on professional advice and stock-picking expertise.

Compensation and Objectivity

In an ideal situation, the primary benefit of a fee-only advisor is that he or she can provide objective advice. At least in theory, these professionals are better able to look at the entire universe of stocks, [bonds](#), mutual funds and [GICs](#) without being swayed by any personal benefits that may come with giving certain recommendations.

Because of the way they are compensated, fee-only advisors can be expected to practice a greater degree of objectivity. To understand how compensation and objectivity are linked, we'll take a look at the commission-based method of paying professionals and why it can lead to problems.

Broker Commissions

Most investment advisors (or [full-service brokers](#)) work for major firms - the Goldman Sachs and Merrill Lynch of the world. But these advisors are employed by their firms only nominally. More often than not, they resemble self-employed contractors in the way their advisory services are melded into the firm's operations.

Advisors employed by a firm have access to its facilities and contact with other professionals in other departments (professional traders, analysts, etc.). Also, advisors have the right to use the firm's name to market their advisory services and to assure

clients that professional activities are backed by a respected firm.

To receive this support from the investment firm, advisors are held to some important obligations. The most important of these provides the firm with its revenues: advisors must transfer a certain portion of their earnings to the firm. The advisors' generate their income by means of commissions, the fees clients pay each time they make an investment transaction. So, it's in the best interest of both the individual advisor and his or her firm to generate increased revenue through maximum trading commissions.

The problem with this method of compensation is that it rewards advisors for engaging their client in [active trading](#), even if this investing style isn't suitable for that client. (For more on the risks involved in active trading and the skill it requires, see the article [Defining Active Trading](#).) Furthermore, to increase their commissions, some brokers practice [churning](#), the unethical practice of excessively buying and selling securities in a client's account. Churning keeps a portfolio constantly in flux, with the primary purpose of lining the advisor's pockets.

Because it's based on an hourly rate, fee-only investment advice is not motivated by the frequency of your trades and is therefore more likely to encourage you to make trades when it's right for you. However, although fee-only professionals help investors avoid the problems of churning, there should be no misunderstanding that brokerage commissions are eliminated entirely. Fee-only advisors may charge by the hour for a la carte services, but investors still need to pay a brokerage to make trades. Commissions are still the primary means by which investment firms make money, and it'll likely stay that way for the foreseeable future.

The Other End of the Spectrum – Premature Self-Reliance

In the great [bull market](#) of the 1990s, there was a rise in do-it-yourself investing, made easy by technology that allowed average investors to access most of the services previously available only through an advisor or broker. First, some investment firms began offering telephone trading systems, whereby clients could enter a trade solely by punching buttons on the phone to select their trades and amounts. Eventually the web broker, or [discount broker](#), came on the scene, and stocks and other investment vehicles could be bought and sold directly from the broker's website with the click of a mouse. This kind of trading offered lower commissions but did not come with the advice and guidance of the full service brokers - giving many investors good reason and motivation to start taking charge of their own finances.

The real appeal of web-based investing was not the trading systems, but the universe of investment advice and information that became available over the Internet. Individual investors no longer had to rely exclusively on their human advisors for access to analyst research, opinions on certain investment products and specific advice on the timing of buying and selling. Better still, much of this advice was available for free and wasn't based on commissions.

Individual investors jumped all over the information, gobbling it up and treating it as if it were the gospel truth. Unfortunately, much of the information was anything but, and a good portion of it consisted of unfounded rumors, rampant speculation and, at its worst, outright lies. Investors often lost a bundle as a result of being caught up in the more nefarious practices on the wild wild web.

It's because of the risks of do-it-yourself investing that the investment professional is still relevant. Very few average investors have the time, education, experience and inclination to achieve the same level of competence offered by many professionals. At their best, investment advisors are disciplined, committed, intelligent individuals who

genuinely aim to help their clients achieve their investment objectives. So if you don't have the time or expertise to do proper research, it may be wise to seek the services of a professional.

Conclusion

The fee-only structure of compensation perhaps allows investment professionals to do well for themselves while taking their clients' best interests to heart. These types of professionals allow investors to access professional expertise while gaining independence from compensation-based advice.

It should be noted that commissioned services may very well be the most suitable for some investors. Particularly in the case of a smaller portfolio where less active management is required, paying the occasional commission is probably not going to be the downfall of the portfolio's returns over the long-term. Yet for anybody who has a very large portfolio to manage, whose investment objectives necessitate frequent trades and active asset allocation, the rise of the fee-only investment advisor is akin to portfolio nirvana!

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