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VOICES FROM THE INDUSTRY

Investors need to be real about their stockbrokers

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Too many investors view their stockbrokers as "professionals" and not the salesmen they usually are. How do brokers find their customers? Most get their clients from cold-calling or inheriting accounts when fellow brokers leave the firm. Some brokers are adept at finding customers at church, the country club or local service organizations.

Compare this point of initial contact to other professionals you deal with. Have you ever been cold-called by a doctor offering you a great deal on that annual colonoscopy? Has a lawyer ever called, telling you that today is the perfect day to file that lawsuit you've been considering?

Other professionals usually don't get clients the way brokers do. What about training and education?

Doctors go to college, plus medical school, plus serve residencies and sometimes fellowships. Lawyers attend college plus law school.

For your broker, college is optional. All he needs to do is pass a few standardized tests by scoring 70 percent or better. Then he gets a little training from his firm and he's ready to do surgery on your nest egg. Do you want your retirement scrambled or sunny side up?

It is usually very clear how much we are being charged for services performed by our professionals. We all know what it feels like to get the bill from the doctor as we leave the office. The procedures are checked off and the total amount due is clearly shown. Insurance will be notified.

If you've ever hired a lawyer, you know the sticker shock of opening that monthly bill, usually itemized, realizing that you will single-handedly be funding the college tuition for some lucky attorney's kid.

Compensation mystery?

One of the great mysteries of the modern world is how your broker is compensated. In certain instances, the amount of total commissions paid to the firm is set forth on a confirmation statement after a transaction is executed. But not always.

If you buy a variable annuity or other related life insurance product, you don't receive any confirmation of the total commissions. This amount is hidden from the investor. And no broker selling such a product is ever going to disclose this to an investor. Imagine how such a conversation would go:

Broker: "I'm recommending you put $1 million into this variable annuity, because I truly believe it is the best thing for you. By the way, I should tell you that me and the firm will be making $80,000 the moment the trade goes in, and there's no other product I could recommend that would make me this big of a commission."

Investor: "Are you kidding me?"

No variable annuities, and very few related life insurance products could ever be sold with this type of honest disclosure.

Hoosier investors bought more than $2.5 billion of variable annuities in 2006. Few of these investors realized the exorbitant commissions paid to their brokers for selling these products. If they had, it is likely most would have politely said, "No thank you."

Almost every broker purports to have some special information, approach, or product that will make you more money. Whether it's a better research department, a better way to time the market, or better computer software to predict future markets, everybody claims to have an edge. It's the most important reason to do business with him.

Does your physician claim to make you healthier than the doc next door? Does your lawyer claim to make you more legal than the downtown firm? Not usually.

No crystal ball

I hate to burst the bubble of most investors, but your broker doesn't have a better crystal ball than anyone else, including you. He can't tell you with any reliability where the markets will be in a week, a month or a year. He can't tell you with any accuracy what a stock will be worth on any date in the future. This is the biggest lie in the business.

He doesn't have any special knowledge or edge to know when to buy an investment or when to sell it. His research department was probably sanctioned by regulators in the last few years for practicing reprehensible conflicts of interest by telling you to buy when they really believed you should sell.

The academic research in the investment field tells us that about 95 percent of brokers, mutual funds, and money managers fail to outperform the applicable market indexes in the long run. Only 5 percent are lucky (and I mean real lucky) enough to outperform the indexes in the long run.

How do you like the odds of your broker being in the lucky 5 percent club?

Investors should look for financial advisors who are more professional advisor than salesman. Contrary to my reservations about brokers in general, there are some good professional advisors in the business.

Your advisor should be familiar with the academic research in this area and be wellversed in asset allocation. A good advisor will give you a full and fair discussion before recommending all purchases or sales, and explain to you in as much detail as you demand, how he is paid.

Fee-based accounts (not commissions) are the better option for many investors. Your advisor should make recommendations that benefit you in the long run, and not sell you products so he can fund his next mortgage or car payment. The good advisor always puts the investor's interest first, before his own.

I am looking into my crystal ball, and I see bad brokers threatening your financial future. Be careful out there.

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