

THE WALL STREET JOURNAL

Why I Hate Wealth Managers

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Certain phrases have the ability to turn this mild-mannered reporter into a ranting, raving, sneering cynic.

Which brings me to "wealth managers."

This moniker doesn't encapsulate everything that is wrong with the investment-advisory business. But it comes darn close.

Ever wondered why it is so difficult for ordinary folks to get decent financial advice? The expression "wealth manager" is a great place to start.

RICH PICKINGS

"When the term 'wealth management' first emerged in the mid-1990s, it was about using an integrated approach that encompassed all of a client's resources," recalls Minneapolis financial planner Ross Levin. "Now it's just a euphemism for asset gathering. The term has been co-opted."

The big move toward wealth management began during the 2000-2002 bear market. As stock prices tumbled, many investors took a huge hit. But Wall Street also felt the pinch. As investors' portfolios shrank and they lost their taste for trading, Wall Street firms collected neither the asset-management fees nor the brokerage commissions they expected.

What to do? Many investment advisers repositioned themselves as wealth managers to the "affluent" and (using another wretched buzzword) the "mass affluent." From a business standpoint, this made sense. You can squeeze a lot more fees out of a \$1 million portfolio than out of \$50,000.

But let's face it, people who have seven-figure portfolios are usually in decent financial shape. By contrast, if you have just \$50,000, you could probably do with some serious help.

USELESS ADVICE

As Wall Street offers (brace yourself) "high touch" handholding to the mass affluent, it spends a heap of time researching issues that affect wealthier folks, such as tax management, exercising stock options, estate planning and dealing with portfolios concentrated in a single stock.

What about issues that matter to ordinary investors, like what size house to buy and when to claim Social Security retirement benefits?

These questions may loom large for most Americans, but they aren't a big issue for the mass affluent.

Similarly, take the question of how much you can safely pull out of your portfolio every year once retired. This topic is fiercely debated among academics and investment advisers.

The resulting research typically suggests that if you withdraw between 4% and 4.5% of your portfolio's value in the first year of retirement and thereafter step up your annual withdrawals along with inflation, you have an excellent chance of making it through a 30-year retirement without running out of money.

Trouble is, for most retirees, this insight is useless. Sure, if you have a truckload of money, you should have no problem living on a safe 4% withdrawal rate.

But if you retire with \$250,000, you can't afford this sort of safety. After all, a 4% withdrawal rate will give you just \$10,000 in pre-tax income. If wealth managers want to help ordinary investors, they need to come up with strategies that generate far more income than that.

CHARGING AHEAD

Investment advisers who style themselves as "wealth managers" usually charge clients a percentage of their portfolio's value each year, rather than charging a commission on each trade. To my mind, this is a vast improvement, because these advisers don't have a financial incentive to push particular products or encourage clients to trade.

Paying a percentage of assets, however, can create three other problems.

First, if an adviser's fee is linked to your account's value, the adviser might discourage you from doing anything that shrinks your portfolio, such as paying down debt, making gifts, increasing spending or delaying Social Security and living off your portfolio instead.

Second, advisers who charge a percentage of assets are usually looking for wealthier clients. If you have just \$250,000, you could still find a fee-charging adviser.

But you probably won't get much handholding and you are likely to pay more than 1% of your portfolio's value each year, making it tough to earn healthy after-cost returns.

Third, even at 1%, we are talking serious money. Suppose you are lucky enough to have \$1 million. A 1% fee works out to \$10,000 a year. If your adviser puts you in mutual funds with average expenses of 1%, that's an additional \$10,000 a year, bringing your total annual investment costs to a whopping \$20,000.

RETAINING HELP

All that said, hiring a fee-charging wealth manager may be your best bet, provided you can find somebody who will help with the full array of financial-planning issues and who will keep your total investment tab, including fund fees, to 1.2% a year or less.

But I would also seriously consider two alternatives, financial planners who charge by the hour and planners who levy an annual retainer.

Today, relatively few advisers charge hourly fees or charge retainers, and I don't know whether such compensation arrangements will be the wave of the future. But they certainly deserve to be. The fact is, if advisers levy a retainer or an hourly fee, they don't have a financial incentive to recommend any particular product or strategy.

True, there are other problems. Retainer arrangements can be costly, sometimes running as much as \$4,000 or \$5,000 a year. That might be a bargain for wealthier families, who would pay far more if they forked over 1% of assets, but it's clearly too steep for ordinary investors.

Instead, those with modest savings should consider an hourly planner. These advisers typically charge \$150 to \$300 an hour. If you use an hourly planner, you may initially need to buy three or four hours of the planner's time. Thereafter, you might pay for a two-hour check-up every few years. The key drawback: If you hire an hourly planner, it falls on your shoulders to act on the advice.

You can find hourly planners by contacting Garrett Planning Network (found on the Web at www.garrettplanningnetwork.com) and the National Association of Personal Financial Advisors (online at www.feeonly.org).

To find an adviser who charges a retainer, try either NAPFA or the Alliance of Cambridge Advisors (www.cambridgeadvisors.com).