Can you really get free and objective investment advice, when you pay investment sales loads? (Part 2 of 2)

Category : Payment of Investment Advisors, Financial Planners, and Investment Counselors

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Summary: This two-part article begins a series of articles by *The Skilled Investor* on investment sales loads and other investment marketing costs. Excessive investment costs are a plague on your personal financial planning. Excessive investment expenses are one of the most significant barriers to lifelong family financial security. While financial services industry sales people tell you that you need to pay more to get more, the correct answer is the opposite. If you pay less, you are likely to get more.

The investment advice you get from commissioned advisors is often anything but “objective.” The scientific investment literature has demonstrated repeatedly and consistently that lowering your investment costs is one of the most important factors toward increasing the performance of your investment portfolio. The quality and objectivity of the advice that you get from commissioned “advisors” becomes more suspect, when you consider that advisors who promote investment products with sales loads will not mention or suggest much cheaper, no-load products as an investment alternative. When you consider that the recommended funds that emerge from this “free and objective” advisory process will typically have significantly higher annual expense charges, then you have even more reason to be suspicious.In this “free advisory” sales process, you may encounter both direct sales representatives/brokers and “independent” advisory industry professionals. When a broker is employed by and directly compensated by the firm trying to sell an investment to you, is it reasonable or naïve to expect that any recommendation will be in your best interest? Many people are taken in by the terms brokers use to describe themselves, such as "advisor" and "counselor." Be careful and read the fine print in the disclosures you are given by brokers. They have absolutely no legal obligation to act in your best interests. (See: SEC's Merrill Lynch Rule Struck Down by the US Court of Appeals)Often, you will find reasons to question whether supposedly “independent” advisory professionals really are independent. Investment advisors are regulated by the Investment Advisers Act of 1940, and are supposed to act in your interests and not in theirs. Yet, when the industry is paying your advisor – even though your sales load expenses provide the funding, you have good reason to question whether your best interests are paramount. Many independent advisors obtain much of their information about investments to recommend from the securities industry. Industry paid advisor compensation arrangements create significant conflicts of interest between your interests and your advisor's interests. Will these independent advisors really serve your best interests, when they are being paid by the industry? (See: Does it matter how financial planners and investment advisors are paid?)The argument that you are getting objective advice that is free because you do not have to act on it, rapidly becomes hollow as the sales process moves forward. Many industry representatives will imply or suggest that the investments they recommend are better investments, while they usually walk a careful semantic line concerning the words they choose. Typically, for example, you will be told that XYZ Fund is a “good” investment, and you will be given glossy brochures and color printed summary sheets with 4 and 5 Morningstar Ratings. The pretty graphics and large text will focus on historical performance, while the legally required small disclosure print tells you not to count on this history. The small print tends to be far more reliable investment advice than the rest of these pretty marketing materials. (See: How Morningstar Ratings for mutual funds are used as a marketing tool and What the instability of mutual fund Morningstar Ratings means for long-term investors – a commentary)Some less sophisticated advisors and brokers will ignore these semantic niceties and flatly tell you that recommended funds with sales load charges are “better.” Sometimes they will even assert that their recommended investments with sales loads actually are superior investments, when compared to lower cost no-load funds. Given that sales loads create higher costs which tend to result in lower investor returns, there are very significant reasons to wonder about the independence of advisors who sell funds with loads and avoid offering cheaper no load funds.Many people purchase investments with loads, because they have been advised or have been given historical performance hints that loaded funds will outperform other funds. There is no support in the scientific finance literature at all for this assertion about the superior returns of loaded funds. In fact, the opposite tends to be true. You are not expected to earn more, if you pay a load. You are expected to earn less. (See: Pay less to get more (Part 1 of 2)In fact, the money that you pay for a front-end load or back-end load will not be returned to the investment fund itself for portfolio management purposes. Even if paying more could possibly fund improved investment results, which is not supported by the scientific investment literature, you sales load payment will not be spent to improve investment results. In fact, the dollar amount that you invest in a fund will be reduced exactly by the dollar amount of the load that you pay. You are expected to earn less, because you have less invested at the outset with front-end loads. With back-end loads, you will pay a percentage of your future asset value, including any subsequent asset appreciation, when you sell. Furthermore, funds with loads tend to have higher annual fees, which will erode your total assets year after year. The sole purpose of a sales load is provide revenue to the firm selling the investment product to you. That firm will in turn compensate the broker or advisor who induced you to make the purchase. Think of the word itself. Does a "load" pulled by an animal, speed up or slow down its progress? There is a reason that investment sales loads are called loads.

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