The investment industry is not your investment partner

Category : Are Your Best Interests the Same as the Financial Services Industry?

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Summary: Individual investors need to understand that their interactions with financial industry intermediaries are a “zero-sum game” before transactions and other costs and a “negative-sum game” after costs. The industry’s visible fees and hidden costs can siphon away a significant part of potential returns without providing individual investors with commensurate value.   The financial services industry offers products and services for investors to buy at prices that include both the market value of the investment securities plus the costs and profits related to the sale. Often the true cost of the industry’s markup is obscured and hidden behind a veneer of “advice.”   Individual investors need to understand that their interactions with the financial markets through these industry intermediaries are a “zero-sum game” before transactions and other costs. In and of itself the industry does not create any additional securities market value beyond providing liquidity, efficient pricing, and convenience. However, the industry can siphon away a significant portion of individual investors’ potential returns through its visible fees and hidden costs. (See: Passive investors are “free riders” who let active traders pay the bills) Adopting investment strategies based on scientific investing is the first part of investment cost reduction. Scientific investment strategies are inherently more cost-efficient, which contributes to improved risk-adjusted returns. This should not be surprising, because a primary goal of investment science is to discover cost-effective strategies that maximize individual investors’ economic welfare. However, even with optimal investment strategies, there is still substantial room to improve upon net investment performance. Skilled investors must carefully identify and control visible and hidden investment costs and taxation to ensure that they obtain the best net returns from their securities assets. Through continued and vigilant focus, investment costs can be reduced and tax realization minimized. Investment cost control also calls investors’ attention to the potentially negative impacts of biased and sub-optimal advice. The costs associated with these conflicts of interest between individual investors and the financial services representatives continually threaten investors’ net returns. (See: Does it matter how financial planners and investment advisors are paid?) Particularly with the abnormally high market returns for equities-based securities during the last two decades of the 20th century, many individual investors became very lax about managing their investment costs and minimizing tax realization. The fees extracted by the financial securities industry increased substantially during this period. At the same time industry deregulation, market innovation, and increased competition provided many new and useful mechanisms for individual investors to manage their assets in a much more cost- and tax-efficient manner. Many investors need to give this topic a far higher priority. Securities investment costs are not “just a few percent.” Instead, they can be a huge portion of your gross returns, and they can dramatically reduce you net long-term investment portfolio assets. See these related articles: ->Excessive investment costs are a huge problem for individual investors   ->Beware of large and hidden mutual fund costs   ->How much do hidden mutual fund trading expenses cost you?   ->Invest in fixed income securities through bond mutual funds with low investment fees   ->Is it worth paying higher bond mutual fund management fees?   ->Passive individual investors are “free riders” who benefit from the higher costs of active traders

->What is the cost to investors of sub-optimal diversification?