

# Choose Wisely

## Selecting Your Financial Advisor

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**EVERYONE IN THE INVESTMENT ADVISORY BUSINESS WANTS TO BE IN "WEALTH MANAGEMENT."** Stockbrokers now call themselves "financial advisors" and financial planners call themselves "wealth managers." So how does an individual or institution cut through all of the spin to choose the right investment manager for their needs?

Just as a hot dog vendor is not a chef, a new title does not make anyone a professional money manager. A free piece of advice... look for the CFA (Chartered Financial Analyst) designation behind the team members' names managing your hard-earned money. The CFA program is the gold standard for professional money managers.

With respect to the question at hand, investors generally have four choices when investing their hard-earned money. They can choose a stockbroker, do it themselves, use the services of a financial planner or hire an investment advisory firm, like Hardesty Capital Management. The right choice depends entirely on what each individual is looking for in an investment manager.

The stockbroker option is probably the most difficult choice to make. Selecting from all of the different companies and their representatives is complicated. Each firm offers a smorgasbord of choices with different fee structures and investment approaches. Adding to the difficulty, investors must sort through the potential conflicts of interest that brokers face. For example, it is in a broker's best interest to amass as many clients as possible. The more clients they accumulate, however, the more difficult it is to service them all. The "80/20" rule applies – you generate 80% of your business from 20% of your clients. Clients of brokers typically pay by the transaction. If your account is not active, the broker does not get paid. Why would your broker call you, or even look over your account, if they aren't going to make money? The flip side is also true. If your broker can make money on your account, their motivation is to transact... that is how they get paid. As the *Wall Street Journal* has pointed out, "It's a lousy arrangement, because brokers have an incentive to encourage trading, even if it isn't in the client's best interests." Research is another area of conflict. Most brokers get their research from their own research department. Are they recommending their brokers buy a stock for their clients

because it truly is a good investment, or do they have investment banking relationships to protect?

Recognizing that the broker model is challenging, an investor can opt to choose to manage his or her own money. Just as patients wouldn't self-diagnose and treat without using a doctor, investors should not attempt to manage their own money. First of all, who has the time? Secondly, the markets can move quickly and companies are more complicated to analyze. Almost all investors need some level of professional assistance. While investors may save money on transaction costs and fees, there are plenty of studies which suggest individual investors collectively have the worst investment performance. To measure how well investors do at investing on their own, one can examine the performance of mutual funds. Not only do mutual funds underperform the stock market – which we will elaborate on later – as John C. Bogle, the president of The Vanguard Group, pointed out in the most recent *Financial Analysts Journal*, "Based on studies comparing traditional time-weighted (per share) returns and dollar-weighted (investor) returns over the past decade, the average fund investor earned an annual return fully 2.4 percentage points less than that of the average fund." Individual investors who try to do it themselves are notoriously bad when it comes to investment returns, which can turn out to be the most expensive choice of all.

The third choice is to approach a certified financial planner (CFP). The CFP tends to offer a more holistic approach, which starts with writing up a formal financial plan, and can include a review of existing financial documents such as wills, life insurance policies and homeowner's insurance. Clearly, the foregoing services offer value. Problems arise, however, from the standpoint that the CFP's typical investment vehicle of choice accompanying their financial plan is a mutual fund product. Setting aside any sales loads, the average equity mutual fund today runs in excess of 1.50% of assets... if the CFP's fee is 1.00% on top of that, suddenly the investor is in the range of 2.00-3.00%, and the proposition can become very expensive. Also, mutual funds generally underperform the market. A study was performed by Robert Arnott, who is a well-respected researcher in the field of portfolio management, and published in the *Journal of Portfolio Management*. The results found that only 14% of all mutual funds outperformed the market over the 10 year period 1989-1998. Only 5% outperformed from

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1984-1998. What are the odds of picking two or three funds that outperform over time? In addition to cost and performance, potential conflicts of interest also exist in the form of some mutual funds offering financial planners marketing incentives to push their product. In the context of recent mutual fund scandals, such practices are now under review by the SEC. It is worth noting that a few of the more forward-looking CFP firms are recognizing the shortcomings of the mutual fund approach and directly employing the services of an investment advisor, to which we turn now.

Investment advisory firms, in our humble opinion, are by far the best choice to manage your money. Echoing Jonathan Clements of the *Wall Street Journal*, you should look for an advisor whose fees, all-in, are less than 1% of the total market value of money under management. Comparatively, our fees at Hardesty Capital Management are less than 1% and there are no hidden fees. Working on a fee basis aligns our interests with

our clients – if their assets increase in value, so, too, does our fee. We only invest in individual securities and each of our client's portfolios is customized in terms of risk tolerance and investment objectives, rather than an off-the-rack mutual fund. And when it comes to taxable accounts, a critical advantage of the investment advisory approach is the ability to control our client's taxes. And last, but not least, we begin measuring a client's investment performance from Day One... it's their performance, not the 3, 5 and 10-year baskets of performance numbers offered by mutual funds, where one's timing of entry is critically important, echoing Mr. Bogle's earlier point.

**Hardesty Capital Management takes pride in being locally owned and being free of the conflicts of interest which are manifest with some brokerage and investment banking firms. We would encourage you find out more about our firm by visiting our website, [www.hardestycap.com](http://www.hardestycap.com), or calling us for an appointment.**



## Investment advisory solutions for individuals and institutions

No two individuals or institutions are the same. Hardesty Capital Management prides itself on **responsiveness** and strives to meet your expectations.

The integrity of our operation is built on one very simple premise:

*We aren't satisfied until our clients are satisfied.*



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