

Do You Really Know the True Cost of Your Advisor?

Many advisors fail to reveal the total costs to clients.

Diversification. Asset Allocation. Portfolio Optimization. Sharpe Ratios. Modern Portfolio Theory. The efficient frontier. The Fama- French Three Factor Model. FI360 Software to maximize Resampled Efficient Frontier.

When it comes to making investment decisions, many consumers know they are ill-prepared to do it themselves. That's why you're smart to turn to a financial advisor for help. A talented, dedicated advisor can help you develop a portfolio that's suitable and appropriate for your situation, one that's designed to meet your goals and can generate higher returns at lower risks — and with less work — than you are likely to obtain on your own.

But how much does it cost to work with a financial advisor? This article will tell you.

As I explained you should always ask how advisors are compensated. Unfortunately, if that's all you ask, you might not be told the whole story. That's because there's often a big difference between what they earn and what you pay. Therefore, instead of asking, "What is your compensation?" you should ask, "What are the total costs I will incur by working with you?"

You see, when your financial advisor provides you with a portfolio of funds, you'll incur not one cost, but three. So it's vital that you receive full disclosure — otherwise, you might end up paying far more than you should, and far more than you realize.

First, of course, is the advisor's fee. Known as an asset-management fee, it is generally expressed as a percentage of assets. At some firms, the asset management fee is as high as 3% per year. (The maximum fee for Schulmerich & Associates, LLC is 1.0%, and larger accounts pay a lower fee.) Instead of assessing the fee in advance (which would mean debiting your account on Jan. 1 for the Jan. 1–Mar. 31 period), the Schulmerich & Associates fee is collected in arrears, meaning you do not pay for our services until after you have received them. To learn the fees charged by other firms and how those fees are collected, you should ask advisors you are considering of hiring for a copy of their Form ADV (Part II & Schedule F), a federal disclosure document that each advisor is required to provide to you.

Stephen C. Schulmerich & Associates, LLC CFP®, CEA®, AIF® Phone 503.672.7750

schulmerich@comcast.net www.schulmerichandassoc.com

The Difference in Costs Between Financial Advisors Who Recommend Retail Mutual Funds vs. Schulmerich & Associates, LLC

Assuming a \$500,000 account

	Retail Mutual Funds	Ric Edelman EMAP	Schulmerich & Assoc.
Median Fee for Assets Under Management	1.25%	1.86%	0.75%
Average Mutual Fund/ETF's Annual Expense Ratio	1.329%	0.36%	0.36%
Average Mutual Funds/ETF's Trading Expenses	1.44%	0.07	0.07
Total	4.01%	2.29%	1.18%

¹Based on data provided by over 1,000 advisory firms for Rydex Advisor Benchmarking Research Study (2008).

²Based on all mutual funds tracked by Morningstar (as of 9/30/08). ³Based on each mutual fund's Statement of Additional Information, according to a study by Virginia Tech, University of Virginia, and Boston College titled "Scale Effects in Mutual Fund Performance: The Role of Trading Costs," (March 2007). This research examined trading costs for a sample of 1,706 U.S. equity funds during the period 1995 to 2005. Schulmerich & Associates uses only no-load institutional funds and exchange-traded funds.

But the asset-management fee is not the only cost you'll incur. In addition to paying for your advisor, you must also pay for the funds your advisor has recommended, and this is where you'll find two other costs: fixed expenses and variable expenses.

Fixed expenses are included in something called the Annual Expense Ratio. Every mutual fund and exchange-traded fund charges this fee — even so-called "no-load" funds. ("No-load" means there are no commissions when you buy or sell shares; it does not mean "no fee.") The expense ratio pays for the fund's recurring operating costs, from the manager's salary to the toll-free phone number investors call to talk to customer service representatives. As of Sept. 30, 2008, according to Morningstar, the average expense ratio for all mutual funds is 1.32% per year, although many are more than 2%. The highest in the industry, according to Morningstar as of September 30, 2008, is a staggering 18.4%!

Although the expense ratio is expressed as an annual figure, it's actually debited on a daily basis. But the charge does not appear on monthly statements, making it hard for investors to notice it. To find it, you must look in the fund's prospectus, where the expense ratio is expressed as a percentage.

Many investors — and, astonishingly, even many investment advisors — think the annual expense ratio covers all fund expenses. But it doesn't. The expense ratio covers only perennial fixed costs — salaries, marketing, overhead, and the like. But there are many variable costs to operating a fund, and these are excluded from the expense ratio.

Stephen C. Schulmerich & Associates, LLC CFP®, CEA®, AIF® Phone 503.672.7750

schulmerich@comcast.net www.schulmerichandassoc.com

The biggest variable costs are brokerage commissions and trading expenses. When fund managers buy or sell a security, they pay brokerage commissions — just like you would, if you were to buy or sell a stock or bond. Of course, funds pay lower commission rates than you would pay. Even so, considering that funds trade millions of shares representing billions of dollars, their trading costs are huge — and the more the fund trades, the more it spends on brokerage commissions. Typically, funds spend tens of millions of dollars in trading costs per year, and these expenses are not included in the Annual Expense Ratio or even disclosed in the prospectus. To find these and other expenses, you must look in the fund's Statement of Additional Information.

Unfortunately, advisors are not required to provide SAIs to you. (They do have to give you prospectuses.) As a result, it's safe to say that few clients have ever even heard of it, let alone even seen or read one. In fact, after training financial advisors nationwide for years, I can tell you that many advisors have never even heard of the SAI. Yet, according to Morningstar, the fees described in an SAI can equal or even exceed the Annual Expense Ratio. Until recently, you had to ask fund companies to mail you their SAIs. But thanks to the Internet, you can now find these documents at most fund company Web sites.

Trading expenses are difficult to determine, but in 2007, an analysis by researchers at Virginia Tech, the University of Virginia, and Boston College found the average fund, based on a sample of 1,706 U.S. equity funds from 1995 to 2005, incurred annual trading expenses of 1.44% per year during that period. This is in addition to the 1.32% that is the average Annual Expense Ratio according to Morningstar as of Sept. 30, 2008, based on all the mutual funds it tracks. These two figures put the total cost of the average mutual fund at 2.76% per year. (This calculation is based on historical data; current figures could vary.)

By adding this to a 1.25% advisor's fee, you can see how ordinary investors can incur a total annual cost of more than 4% per year.

So be careful when asking an advisor what his or her charges are. If the answer is, "My fee is one percent," he might be omitting the Annual Expense Ratio and trading expenses that you'll also incur. So when you are interviewing potential advisors, make sure they tell you the total costs you'll pay to work with them.

NOTE: The chart shown above is for illustrative purposes only and does not represent the actual fees and/or expenses of any specific retail mutual fund. The actual fees and/or expenses associated with a given mutual fund may be different. All figures are based on historical data; current figures could vary. This chart and the accompanying article refer to advisors who recommend mutual funds and exchange-traded funds to their clients. If your advisor recommends individual securities, such as stocks and bonds, a private money manager, or a separately managed account containing individual securities, you must be careful that you are being told the total costs of such arrangements, which can include management fees, brokerage commissions, trading expenses and other fees.