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7 Ways to Avoid Picking a Bad Advisor

By Gil Weinreich, ThinkAdvisor Editor-in-Chief Research Magazine

Wealth manager Eric Nelson offers guidelines for investors after a veteran financial journalist gets blindsided by egregious advice

Don't let this be your client when she sees what you've done to her portfolio.

If a veteran ***Wall Street Journal*** editor covering the wealth management beat manages to get duped by his financial advisor, what chance do ordinary investors have of a positive advisor-client relationship?

In a courageous column published two weeks ago, an "embarrassed" Kevin Noblet, a 60-something editor "with experience and gray hairs," writes of his decision to cede his personal management of his and his wife's portfolio to a professional, and of the disaster that led him to fire his advisor nine months later.
While the 60-something advisor he hired made a number of dubious decisions in his stewardship of the Noblet portfolio, a 30-something Eric Nelson, principal of Servo Wealth Management, shared his critique of Noblet's hiring decision with his clients.

He also offered ThinkAdvisor readers some additional insights into what investors should look for in an advisor and, concomitantly, what standards advisors should aspire to to distinguish their service offering.
Noblet was thinking a professional advisor might have greater "understanding of certain assets" and "know the world of active stock-fund managers well enough to pick good ones." He also thought he would "worry less,

and sleep better," especially since a professional would be on hand to assist his wife if he "got hurt or died" suddenly.

Nelson credits Noblet for understanding the value an advisor can play in relieving his clients' portfolio anxieties, but insists that it is foolhardy to think anyone has the ability to consistently select outperforming managers.

Noblet also looked for a small firm led by a gray-haired advisor. Once again, Nelson gave him one out of two points. Small is good, he says, since no investor should have to compete "with 400 other clients for their advisor's attention." As to age, however, the Oklahoma City-based RIA in his upper 30s says "a few years of experience, intense study and education" are key, and that an older advisor should prompt prospective clients to ask: "who will be retiring first, you or me?"

Perhaps the most painful aspect of Noblet's experience was how his advisor "immediately redeemed all of our mutual funds," shifting into funds the advisor preferred, without paying heed to the tax consequences. A couple of Noblet's funds were just shy of their anniversary, when profits become lower-taxed long-term capital gains.

Nelson finds fault with Noblet's ignorance of what the advisor's plan was, stressing the importance of an investment policy statement (IPS), in addition to noting that Nelson manages *his* clients' tax consequences over periods as long as two to three years if warranted.

Adding insult to injury, Noblet's advisor used costly funds, some with expense ratios exceeding 2%, in addition to the advisor's 1% fee, compounding the losses that the advisor's frequent short-term trades generated. Those trades were typically inspired by information Noblet's advisor got at "advisor gatherings," which caught this wealth management beat editor by surprise, as he wrote:

"My job took me to similar gatherings. I had seen how marketers of mutual funds blanketed those events, sponsoring lavish dinners and pitching products. Who had my advisor's ear?"

Beyond Nelson's critique of this painful confession, ThinkAdvisor asked the savvy blogger how he would advise investors to select a professional, and by implication, what standards should advisors aspire to. Nelson suggested the following seven criteria:

"**No. 1 — Structure:** Find a firm that is a fee-only RIA — that is the only way you know for sure you are eliminating conflicts or at least that they are being fully disclosed. Know exactly how much you will be paying on an ongoing basis — for advice, and for the investments you'll hold," Nelson says.

"**No. 2 — Service:** Make sure the firm provides the services you are looking for: assistance with planning and investing *for* retirement … or planning and investing *in* retirement including a documented approach to generate the cash flow you'll need today and in two to three decades. Or if you are instead trying to create a legacy for future generations, know that they have … experience with that," he says.

"**No. 3 — Support:** How will you be working with this firm? Will your advisor be the one you meet with in initial meetings, or are there relationship specialists at the firm that handle the client management? Will you be serviced by a team or a single individual?

"**No. 4 — Investing:** Only work with someone who takes a broadly diversified, buy/hold/rebalance approach to investing. The likelihood that you'll have success with a market timer or stock picker is very slim. And find out how your advisor invests *their* money. If they follow the same philosophy as the one they recommend for you, then you know you're 'in it together,'" he says.

"**No. 5 — Process:** Have a solid understanding of how your advisor will actually invest your money. What will your asset allocation be? Why is this most appropriate? What asset classes will be in your portfolio? What's the rationale behind them? How will your portfolio be maintained? Will your advisor rebalance or will they use tactical timing moves based on their forecast of future interest rates, politics, valuations, economic cycles, etc. If they plan to rebalance, will they do so based on a particular horizon (quarterly or yearly) or based on a % threshold (when 40% in bonds are up to 45% or down to 35%, for example).

“**No. 6 — Documentation:** Will you get all of this in writing ahead of time or upon becoming a client? Will you get an IPS that clearly outlines your goals and objectives, the portfolio management process you are following, and your particular portfolio holdings?” he continues.

“**No. 7 — Follow-up:** What will be your … interaction with your advisor on an ongoing basis? What are your expectations? Will it be face to face, over the phone, a combo of both? Does the advisor provide written materials to support personal or virtual meetings? What is the best way for you to utilize those services?”

The advisor-blogger adds that the ***Wall Street Journal*** editor’s experience is far from rare, that highly intelligent people frequently wind up in relationships governed by principles that may be the opposite of their beliefs.

The antidote to this malady is simply the ability to follow a checklist like his proposed seven steps.

And to cynics who think one who has the requisite knowledge to *find* a good advisor has the capability of *being his own* good advisor, Nelson adds that a third party professional can be invaluable in helping a client “stick with your plan during a 2008-like period or avoid going headlong into stocks after a good 5.5-year period for equities.”

Perhaps the hallmark of a humble advisor who understands what role he can usefully play is alluded to in Nelson’s concluding comment:

“We cannot (nor can anyone else) control market outcomes, so we focus our efforts on controlling our client’s behavior.”