

# THE WALL STREET JOURNAL SUNDAY

**Getting Going** / By Jonathan Clements

## What Is That 1% Fee Buying You?

If they won't compete on price, let's make them compete on service.

Got a broker or financial planner who is charging you 1% of your portfolio's value each year and all you're getting are mutual-fund recommendations? If you have a portfolio worth \$400,000 or more, take this column along to your next meeting, slap it on the adviser's desk and demand an explanation.

The fact is, some folks pay 1% of assets and get the full panoply of financial advice, including help buying cars, insurance and homes. Meanwhile, others pay the same 1% and have nothing to show for it but a slew of mediocre mutual funds. If you're in the second camp, it's time to demand more for your money.

### Claiming Their Cut

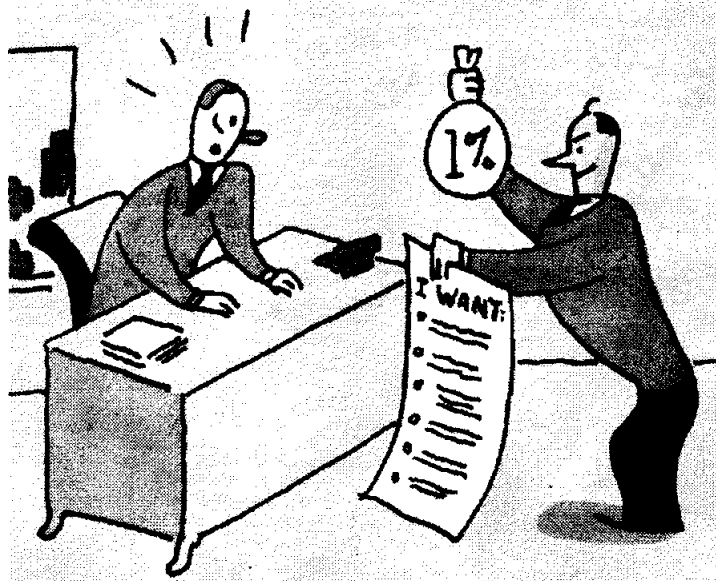
Like it or not (and I don't), the standard charge among fee-based brokers and financial planners is 1% of assets. Yes, there are advisers who charge less. But they are few and far between.

Brokers and planners talk about that 1% as though it is their birthright. Indeed, that figure has even been institutionalized in mutual-fund C shares. With C shares, there is typically no upfront or back-end sales commission, except for a small sales charge if you unload your shares in the first 12 months. Instead, these funds levy 1% a year, in the form of a 12b-1 fee, which is then used to compensate the advisers who sell the funds.

What if you work with a broker or financial planner who charges commissions or some combination of commissions and a percentage of assets? The amount you pay will vary from year to year, depending on how much trading you do. But over time, you will likely incur costs similar to those levied by fee-based advisers.

"No matter how you cut the mustard, it generally comes out to between 0.8% and 1% a year," says Richard Ferri, a former broker who now runs Portfolio Solutions, a money-management firm in Troy, Mich.

To be sure, 1% may not sound like much. But as Mr. Ferri notes,



Marc Rosenthal

"that's not the total cost. That's just what you're getting charged for advice."

### Damaging Your Returns

If your adviser then invests your portfolio with mutual-fund managers or with private money managers, these managers will also take a cut. Still, the expense might be worth it, if your adviser helps you to beat the market and thereby recoups the costs involved. But frankly, that is so unlikely that the notion is almost laughable.

Suppose your adviser stashes your portfolio in stock-mutual funds. If you ignore 12b-1 fees, these funds charged average annual operating expenses of 1.2% in 2002, according to the Investment Company Institute in Washington. In addition, stock funds might rack up another 0.8% a year in brokerage commissions, trading spreads and other transaction costs, estimates the Bogle Financial Markets Research Center in Malvern, Pa.

Tack on another one percentage point for your adviser's fee, and you are looking at a total annual tab of 3%. In other words, to beat the market, your fund managers would have to pick stocks that outpaced the stock-market averages by more than three percent-

age points a year.

Your adviser might get lucky, selecting a collection of managers who fare that well over three or even five years. But how many advisers could overcome that 3% annual hurdle over a lifetime of investing? You could probably shake hands with all of them at the same time.

### Demanding More

What we need, of course, is more price competition. There is some of that going on. For instance, Mr. Ferri's annual investment-management fee is just 0.25% of assets, and even less for larger accounts.

But I don't see a lot of brokers and planners following Mr. Ferri's lead. My response: If advisers won't improve the odds of good investment performance by cutting their fees, then investors should demand more service.

Whether you pay 1% of your portfolio's value or you pay commissions every time you buy and sell, it might seem like you are paying for investment management. But charging commissions or charging a percentage of assets is just a convenient and relatively painless way for advisers to extract their fee.

In fact, investment manage-

ment is probably the least valuable service you get. It doesn't take any great brains to put together a well-balanced portfolio of mutual funds. At the same time, it's also highly unlikely that the funds selected will generate market-beating performance.

Instead, when you pay your 1% or pay commissions, the real value comes from the help you get with other aspects of your financial life. Consider Accredited Investors Inc., a Minneapolis financial-planning firm that charges 1% a year on the first \$5 million.

In addition to picking investments, Accredited will help clients with estate planning, refinancing their mortgages, tax planning, college funding, retirement-income projections, exercising stock options, negotiating new car purchases, analyzing insurance and purchasing homes.

"The investment management is worth 0.3% or 0.35% a year," figures Accredited President Ross Levin. "All of these other services are worth the other 0.65% or 0.7%."

Mr. Levin says clients do incur a few extra costs for these additional services. For instance, while Accredited will help clients formulate their estate-planning strategy, they will pay an attorney's fee to get the necessary documents drawn up. Similarly, while Accredited will work to minimize taxes, clients may have to pay extra to get their tax returns prepared.

Mr. Levin's firm has a \$1 million account minimum, so he is clearly catering to fairly wealthy investors.

Still, Mr. Levin reckons that, "once you get up to \$400,000 or \$500,000, you should be getting supplementary services. If you're not, you shouldn't necessarily pull your money and leave. But you should sit down with your adviser and ask, 'What other services can you offer me?' You shouldn't be paying 1% just for investment management."

Jonathan Clements also writes the "Getting Going" column that appears Wednesdays in The Wall Street Journal. Write to him at: [johnclements@wsj.com](mailto:johnclements@wsj.com)