LPL Financial

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Evaluating Professional Advice: 11 Questions to Answer Before You Commit

Professional advisors differ in their philosophy, processes, services, education, experience, and their ability to add value. Here are questions that can help you make a good choice.

Obtaining professional advice is a significant step and should not be approached lightly. As with investors and their objectives and constraints, professional advisors also differ in their philosophy, processes, services, education, experience, and their ability to add value.

Professional advisors work in many fields and hold various titles, such as investment advisor, financial planner, accountant, estate planner, insurance agent, and stockbroker. Over the last few years, most professional advisors have seen their roles expand and now the lines among them have become greatly blurred. Today it is now commonplace to meet an insurance agent who is also registered as an investment advisor or a stockbroker who engages in the practice of estate planning.

With so many potential professional investment advisors to choose from, the process can seem daunting. Remember, not all professional advisors are equal! Some advisors may say the same things as others, but when you investigate further you will discover significant differences. The following are 11 questions you should investigate when evaluating a potential financial advisor.

Question 1: What financial services do the advisors offer?

It is important to first determine what services you are seeking: investment counseling, total financial planning, estate planning, and/or tax preparation. When you know that, you should investigate whether or not the advisors offer these services. This is important because most professional advisors do not offer a complete array of services. It is common for advisors either to have relationships with outside advisors who can address the areas not serviced or, if their firm is large enough, to have someone else in their firm handle separate services.

Question 2: Do the advisors offer customized portfolio solutions or more of a cookie cutter solution?

Regardless of your financial objectives and constraints, some financial advisors only offer one or two approaches to managing wealth, specifically portfolio management. For instance, you may find advisors who build practically the same portfolio for all of their investors without taking into consideration their ability or willingness to tolerate risk. Most financial advisors realize that customized portfolios provide the best way to achieve investors' goals and objectives. However, be cautious and ask how tailored their portfolio solutions are.

Question 3: What are the specific qualifications of the advisors?

What education do the investment advisors have? Bachelor's? Master's? Find out what their degree is in: finance, accounting, marketing, economics, literature? You would be surprised at the number of practicing advisors who have either no bachelor's degree or a degree in a field unrelated to finance and investing. You should also investigate whether or not the advisors have earned professional designations, such as CPA (Certified Public Accountant), CFP (Certified Financial Planner), CFA (Chartered Financial Analyst), or ChFC (Chartered Financial Consultant). Having a designation illustrates commitment and very specialized knowledge that can separate the top advisors from the rest of the pack.

Question 4: How much and of what type of experience do the advisors have?

You should find out how long the advisors have been in practice and how long they have been in their present role. A follow-up question could address the advisors' specific work experience. Also, do not be fooled by age. Many advisors who enter the business late in their careers have as much (or as little) to offer as someone straight out of college.

Question 5: How ethical and trustworthy are the advisors?

This question is obviously very subjective and not always easy to answer when you first meet potential advisors. A good way to approach this question is to investigate their backgrounds, specifically whether a regulatory organization or private association to which they belong has publicly disciplined them. To check on an advisor's regulatory records, you should contact FINRA (Financial Industry Regulatory Authority, Inc.) or any association the advisor may be a member of, such as the Certified Financial Planning Board of Standards or the CFA Institute.

Question 6: What are the advisors' investment process and investment philosophy?

Some advisors have been known to "wing it" when designing portfolios because they either have no philosophy or fail to adopt one. You should ensure that advisors you are considering incorporate asset allocation into their investment philosophy and apply it to their portfolio management process. Also, you should consider investigating whether or not advisors adopt some sort of plan for building an optimal portfolio. Asking questions at this point is very wise and will minimize issues going forward.

Question 7: What is the advisors' tax management philosophy?

Advisors approach the tax management issue from different viewpoints. Some advisors underemphasize tax management while others overemphasize it. Specifically, ask about the general degree of turnover, how they incorporate tax management into the rebalancing phase, whether or not they can incorporate tax losses or gains generated outside of the portfolio, and how they approach the issues of loss-harvesting and exchange strategies.

Question 8: What are the fees and by what method are the advisors paid?

There are many ways an advisor can be compensated: commission, a percentage of a portfolio's market value (asset-sized fee), hourly fees, fees for individual services performed, or any combination. There is no right or wrong fee structure. The best fee structure is what makes sense and is the best fit for you. Most advisors will be able to provide the investor with a written document outlining their fees. If an advisor cannot provide this, move on. Don't be afraid to ask about fees up front.

Question 9: What is the long-term performance or track record of the advisors?

The vast majority of advisors can provide you with some sort of performance composite for you to review. When reviewing performance information, be sure to learn which benchmark(s) are employed (such as the S&P 500), how well the advisor performed against the benchmark(s), the consistency of performance over long periods of time, the volatility of performance [especially in relation to the benchmark(s)], the growth of assets under management, and the statement of whether or not the performance conforms to CFA Institute standards. If any of these items are not voluntarily provided, ask the advisor to provide them. If the performance was not created according to CFA Institute standards, ask why. Performance is suspect when the advisor has not conformed to any standards, especially the tough CFA Institute standards. The CFA Institute is the organization that oversees the Chartered Financial Analyst (CFA) designation.

Question 10: What is the profile of their typical investor?

Your goal here is to find out whether or not the advisor under investigation is knowledgeable about your objectives, constraints, problems, and solutions. Some advisors work with everyone, thus are jacks-of-all-trades, whereas others work only with specialized groups of people, such as affluent investors; thus they are exposed day in and day out to the issues faced by that group and how best to deliver a targeted solution.

Knowing the typical clientele gives you a good idea of the type of problems and solutions the advisor is most experienced with. Since some people require very specific financial solutions, knowing the typical investor will help you to discover whether or not that advisor can effectively work with you.

Question 11: Is there a personality fit?

The last question deals with whether or not you can work with the advisor. This question is more intuitive-oriented rather than objective-oriented. Usually after the first meeting you will know if there is a fit or not. Is the advisor more serious or humorous? Is the advisor intense or low-key? Is the advisor more professional or down-to-earth? Does he or she play golf? Did a friend refer you? Are your interests similar? Questions like these will help you determine if your personalities mesh, which makes dealing with each other so much easier.

In addition to the questions presented, another good way to evaluate an investment advisor is to review what is called Form ADV Part II. This form is required by the Securities and Exchange Commission (SEC) or the state of domicile of all investment advisors. In addition, all investment advisors are required to provide this document to prospects before any services are provided. If you are not given one, be sure to ask for it.

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