How To Select A Financial Advisor

Seth E. Lipner 10.26.09, 12:00 PM ET

This last year was a bad one for many investors. As a result, lots of investors are changing advisors, or thinking about doing so. The decision to change is sometimes a hard one to make, but deciding on whom to change to is hard every time.

Investors ought to be concerned with the quality of investment advice whenever an investment's performance diverges from the investor's perception of the riskiness of the investment. Performance that diverges from expectations is a signal that something might be wrong, and in the last year too many people got that signal. It was hard to ignore.

There is no simple formula, no single set of questions to ask or guidelines to follow when searching for a new advisor. One must, of course, know the different types of services offered by the different types of advisors--a subject covered in my last column. (See Know Your Broker Better.) But if you are thinking about changing brokers or advisors or whatever, or if you are wondering whether your current advisor is the right one, you can probably use some suggestions about how to find a competent investment advisor.

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Here are 10 things to think about.

1. **Experience**--An advisor should have an appropriate amount of education and business experience. While a "finance" or business degree is not required, an advisor's level of education is important. Experience is even more crucial. Advisors who have not experienced at two least two market cycles probably don't have enough perspective.

2. **Condescension**--Beware of any advisor who belittles your concerns about risk, or who encourages you to buy investments you don't fully understand. Fancy or complicated investments are rarely good ones.

3. **Writing**--An advisor should give you something in writing that describes the investments the advisor will recommend or make. Beware the advisor who tries to push a single product, or who says you have to decide right now lest you miss an opportunity.

4. **Compensation**--An advisor should tell you how he or she will be compensated, and how much the fees are for each transaction. Be suspicious of high-fee products, like variable annuities. And always remember that an investment account is like a bar of soap; every time you touch it, it gets smaller.

5. **Wherewithal**--An advisor should have sufficient financial wherewithal to make good a mistake or worse. An advisor should either be part of a large organization (like a bank, or a national or regional brokerage firm), or, if they are from a small firm, they should carry "errors and omissions" insurance. When dealing with local firms, small firms or solos, you must ask about insurance. If the advisor appears offended by the question, or says "no," that advisor cannot to be relied on to invest your money.

6. **Referrals**--A referral from other professionals (e.g. a lawyer, or an accountant) can be a good place to start, especially when accompanied by statements like "I've sent other clients to this person, and they've been happy," or "I've known this person professionally for 20 years." Beware of referrals by professionals of their friends or relatives; these referrals are not objective.

7. **Internet Search**--Conduct due diligence. Run a Google search. Check the FINRA Web site (www.finra.org) under "Broker check." Ask for examples of what the advisor has done in the past for clients, and ask how that worked out, especially in bad market conditions. Be curious. If anything makes you uncomfortable, go elsewhere.

8. **Remain Vigilant**--If you are not capable of or inclined to review periodic account statements, employ another professional to keep an eye on your advisor, even if you must pay for that service. It's like getting a second opinion before surgery--you need to do this.

9. **Track Record**--Past performance is not an indicator of future profits, but it is definitely an indicator of risk. Avoid managers and advisors who claim to way out-perform the market or their peers. It probably means they are taking more risk.

10. **Risk/Reward**--Beware of advisors who tell you they can increase your income without increasing risk. What most investors don't realize is that an increase of just 1% per year in the yield of a bond portfolio means taking on significantly more risk. The more an investor "needs" the income, the more important it is to make sure the investor's principal is secure. "Chasing yields," as it is known, can be a dangerous strategy.

Investors cannot afford to put blind trust in an advisor or a financial services company. When selecting an advisor, investors cannot be shy. They must know the questions to ask, and be able to spot the warning signs when something is amiss. It's a tough task, and even smart people too often get it wrong. The only thing harder than finding a good advisor may be making investment decisions without one.

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