DRIVING A HARD BARGAIN:

Lessons from a Car Dealership on Spotting Financial Red Flags

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I recently visited a car dealership with my nephew for his new truck. After some back and forth, we found the one that interested him. Then came the most dreaded words any new car buyer can hear, “Let’s go back into my office and run the numbers”. The term sheet was pretty good, and the monthly payments were within his budget, but we weren’t convinced yet. I told them we would think about it and return the following day.

When they called the next morning, they knocked off another $1,000 and we were sold. After 30 minutes of waiting around and getting the documents in order, my nephew started to sign the paperwork... until he saw his monthly payment had gone up by about 20%. The classic bait and switch... get the customer up to the point of no return and then pop the payment. The official excuse was that they had been using an old interest rate to provide the estimate and this was the market rate. Needless to say, there was no new truck that day.

This car sales fiasco got me thinking, were there any red flags we could have noticed before going the distance? Or more importantly, what are the red flags I see most often with other financial advisors that I can help you avoid?

I. PORTFOLIO (MIS)MANAGEMENT

By far this is the most concerning and common issue I see with other advisors' work. I reviewed a portfolio last week from a local advisor managing a trust for a young adult. It is down for the year while all the relative benchmarks are up over 5%. Further analysis revealed a portfolio that was invested almost exclusively in mutual funds. Each of these mutual funds carried a 5% load (financial jargon for a built-in sales commission), and an annual expense ratio of over 1%.

They all happened to be an affiliate fund company of the advisors' bank which means the advisor likely received extra compensation for referring his client to them. Beyond the obvious issues above, mutual funds are an inferior investment vehicle in nearly all circumstances to ETFs. **If your portfolio is primarily invested in mutual funds, this is a red flag.**

II. THE SALES SHARK

We have all been solicited by a "financial professional". Some are well-intentioned and some are not. Unfortunately, there are many financial professionals out there and most are not bound to do what is in their clients' best interest legally. I have yet to meet an annuity salesman who does not recommend that you buy his annuity, regardless of your circumstances. I guess when you are a hammer everything looks like a nail.

Most of these products are expensive, offer poor performance, and worst of all, are not returnable. They are recommended to take money from your pocket and put it into your advisors. **If your so-called financial advisor only tries to sell you annuities or life insurance, this is a red flag.**

III. THE WARREN BUFFET OF LEESBURG FLORIDA

I have had many conversations with financial advisors about their investment prowess. Some make boastful claims, but few have the results to back it up. Be wary of advisors who promise unusually high returns with little or no risk. The world of investing involves risk, and any advisor who claims otherwise is not being honest.

Unrealistic promises are not just unethical – they're often a sign of incompetence, or worse, fraud. If your advisor really has found the secret to investing, he wouldn't be advising you. Rather, he would have billions and billions in his personal portfolio! **If your advisor promises high returns and no risk, this is a red flag.**

IV. THE ONE-SIZE-FITS-ALL APPROACH

Beware of advisors who offer a cookie-cutter approach to investing. Your financial goals, risk tolerance, and personal circumstances are unique. A good advisor augments different strategies to fit your individual needs, rather than pushing generic investment products. Your advisor should be investing your assets based on some sort of financial plan or goals. If your advisor's approach to you is the same as any other client of theirs, this is a red flag.

V. CONCLUSION

This is not a complete list of red flags, but it is a starting point. There are so many advisors out there and it can be hard to separate the good ones from the bad. When evaluating new professionals, I always try to reflect on the 3 C's: Character, Competency, and Caring. If you are having any doubts about your advisor, you should seek out a second opinion.

QUESTIONS?

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