Questions to ask a Prospective Financial Advisor (and some thoughts on responses)

By Brett Bina, CFA, CAIA

Portfolio Manager, Prescott Financial

Interviewing a new wealth manager can sometimes feel daunting, but it doesn't have to be. Many wealth managers are highly qualified: credentialed with impressive CFA or CFP designations, experienced in serving clients big and small, and come recommended by your accountant, attorney, or friend. Aside from their results for clients, what else should you be looking for to indicate if a client-wealth manager experience will be successful? Keep reading for some questions you might ask along with a guide on assessing responses.

Question: Do you use the same investment approach for your own personal money as you recommend to clients?

Suggested Response Assessment: In other words, does this manager eat his or her own cooking? Some advisors have compliance restrictions on what they can and can't own, but many don't. If an advisor is suggesting a set of high-fee mutual funds or strategies run by an external firm while investing their own money into more lucrative growth assets, you must wonder if you are getting their best investment advice.

If it's a non-compliance reason as to why this prospective manager doesn't invest the same way they recommend clients with similar net worth and goals to invest, you may question their impartiality. Similarly, it may highlight that manager's risk aversion or view of the capital markets. If a manager suggests you build a higher-risk portfolio yet keeps most of his or her money in property or lower-risk government bonds or CDs, you might wonder if they know something you don't. Remember - the best chefs tend to eat their own cooking and that is often the case in the investing world also.

Prescott Financial
www.prescottfinancialgroup.com
111 S Moody Ave, Tampa, FL 33609

T (813) 820-1626
F (813) 377-4208
E brett@prescottfinancialgroup.com

Question: Who is the decision maker for investing the funds in my account? How are those decisions made?

Suggested Response Assessment: This simple question can reveal a lot. Many wealth managers don't manage money in-house. Instead, they may outsource this mission-critical task to sub-advisors in the form of mutual funds or separately managed accounts. That's not to say that these wealth managers who outsource money management are not highly skilled in picking managers, but they may not have direct capital markets expertise to perform research on or make security-level investment decisions with respect to individual stocks and bonds you'd like to keep in your portfolio. This question should be answered simply, and you should know the names of the individuals managing your money – whether they work at a mutual fund in another city or sit right across the office from your prospective advisor. Managing money in-house is hard and not in every wealth management firm's wheelhouse. Alongside financial planning, running the investments is the most important part of wealth management. Understanding who the decisionmaker is, how portfolio decisions are made, and the rationale for any changes is critical to your financial success.

Question: How do you mitigate the effects of taxes on my portfolio? Can you tell me about a time that you have partnered with clients' CPA for tax planning?

Suggested Response Assessment: Taxes are a huge deal for investors at all levels. None of us like paying more than our fair share, so it's important to know what strategies your wealth manager will employ to help reduce taxable events, such as harvesting losses to reduce current and future taxes or leveraging estate planning tools like annuities or life insurance to reduce your tax burden down the road. Simply encouraging clients to max out their 401(k) plans at work isn't good enough anymore. The wealth managers of the future are helping clients determine an overall tax mitigation strategy that looks to reduce your tax burden today and over your entire lifetime.

Reducing your current exposure to taxable gains can be driven by a thoughtful tax-loss harvesting strategy. According to a 2019 paper by MIT economist and investor Andrew Lo, investors may consistently add over 1% per year to their returns with careful tax-loss harvesting*. That might not sound like much, but over a few decades with a couple million invested that could amount to hundreds of thousands of dollars that stay in your pocket, shielded from taxes.

Other strategies that can offer significant tax benefits include Roth IRA conversions, annuities, and insurance. Some managers are well-versed in using these instruments as part of a client's wealth strategy and leaders in the industry have spent years lauding the benefits of Roth IRA conversions. A good advisor equipped with planning skills can run what-if analysis using state-of-the-art software help determine if Roth conversion is a good fit for your wealth plan. Annuities and insurance can be also used as estate planning tools. They offer tax benefits because annuity income isn't taxed during the accumulation period and life insurance proceeds are typically paid tax-free. Some firms specialize in strategies that are highly tax-inefficient, such as dividend portfolios. While these strategies may be attractive from a volatility minimization standpoint, they often target companies that are being disrupted or have less favorable growth prospects. The dividend payments also create a surplus of taxable events that may not be optimal for younger or more affluent investors who don't need the dividend income now. Achieving a balance between growth, safety, liquidity and tax impact is key.

Question: Are there any types of investments, market sectors, or products that you aren't as well versed in?

Suggested Response Assessment: Ask this after the manager lays out his or her core strategy offering or proposal. The menu of investments available to current and future retirees is long and complex and grows larger every day. A manager who only covers a value style and isn't as well-versed in growth stocks may not be the best fit for an investor with a very long-term time horizon who doesn't need immediate income.

A good answer to this question can also demonstrate the prospective manager's self-awareness. Given the vast array of potential investment options, none of us have a full handle on every single investment opportunity available. A manager who claims to know everything about everything may raise doubt on themselves as a subject matter expert. Not being an expert on everything under the sun shouldn't be seen as a disqualifier and may be interpreted as a sign of candor and a good emotional quotient (EQ), which tends to correlate highly with successful investment teams and outcomes **.

Question: Can you tell me about a time that an investment didn't go as planned?

Suggested Response Assessment: Again, it shows candor, reflection and a high EQ to answer this well. Every manager has made mistakes. Whether big or small, these mistakes provide an opportunity for reflection, learning and growth. Many of us, even longtime professionals, have been lured by the siren song of fast returns only to be disappointed when the vast riches we expected aren't achieved. It's ok to lose on occasion, but having a disciplined process and a method for risk management can lead to successful outcomes. Which brings us to…

Question: What is your process for risk management?

Suggested Response Assessment: In bull markets, this question isn't asked as much as it should be. Managing risk is among the top skills a money manager can bring to the table. There should be some clearly defined parameters that help determine buy and sell decisions, as well as a philosophy and approach to measuring risk. There are no right or wrong answers as this question provides valuable insight into a manager's philosophy.

How do they define risk? How do they feel about the current market's backdrop and the broader economy and why? Any of these are good conversation starters and help demonstrate a manager's understanding of risk within capital markets and investing.

Question: What role does financial planning play in your process? How often do you update clients' financial plans? Will I have direct access to any planning software or dashboards to run my own analysis?

Suggested Response Assessment: Some managers delight in building robust financial plans for clients to help guide them along the way to retirement or financial security. Others see it as more of a chore that gets in the way of raising more assets, networking lunches and growing their business. If your

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E brett@prescottfinancialgroup.com

prospective manager isn't sitting down with you regularly to discuss your financial plan and any changes on the horizon, they might not be the best fit for you. A great manager will help you understand the trade-offs between your current consumption and future wealth, how varying market returns may affect your ending wealth balance, and how to use various financial planning reports. Many firms offer direct access to a financial planning tool, which can help you easily see your net worth and portfolio values. These tools can also facilitate conversations about the trade-offs between risk and return.

In summary, there are many possible questions to ask a wealth manager. You've worked hard to build your wealth, and your wealth manager should be working hard for you too. Don't be afraid to ask hard-hitting questions or follow-up with more queries. The best wealth managers will welcome the conversation, are transparent on how they manage client funds, and will have the self-awareness and market skills needed to serve you and your family's financial needs for years to come.

Sources:

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E brett@prescottfinancialgroup.com

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