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From *Canadian Business Online*, August 28, 2008

Financial advisers vs. academia

Studies: Advisers are of little benefit.

By Larry MacDonald

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Do investors need financial advisers? Not according to some university professors and other researchers.

Financial advisers say they have the expertise to guide investors to better results and can keep them from making mistakes such as under-diversifying, chasing hot funds/stocks, and selling out at the bottom of a bear market. However, empirical studies carried out by academics find otherwise. Let's take a look at three.

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1. In their study, "[Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry](#)," Daniel Bergstresser (Harvard Business School), John Chalmers (University of Oregon), and Peter Tufano (Harvard Business School) analyze a database of U.S. mutual funds from 1996 to 2004. Their objective was to compare the performance of investors who bought funds through broker-dealers to investors who purchased funds directly.

They found that investors with broker-sold mutual funds experienced "lower risk-adjusted returns, even before subtracting distribution costs." They also found that investors purchasing broker-sold funds were directed into funds with "substantially higher fees" and failed to show superior asset allocation. And as for helping investors avoid behavioral biases, "regrettably, the advisers generally demonstrated all the same biases that the rest of us have."

2. In "[Investor Timing and Fund Distribution Channels](#)," Mercer Bullard (University of Mississippi), Geoff Friesen (University of Nebraska-Lincoln) and Travis Sapp (Iowa State University) also compared the performance of U.S. mutual-fund investors by distribution channel. They found that brokers did not prevent clients from buying high and selling low — i.e. from exhibiting poor investment timing.

Comparing asset-weighted and unweighted returns, investors in funds with front/rear loads and/or annual fee (sold by brokers) were found to have purchased and sold their funds more than investors of no-load index funds. Investors in load/annual fee funds consequently underperformed a buy-and-hold approach whereas investors in no-load index funds closely approximated the buy-and-hold approach.

The study's conclusion leaves little doubt about the authors' opinion of the utility of financial advisers. "We find that investors who transact through investment professionals using conventional distribution arrangements experience substantially poorer timing performance than investors who purchase pure no-load funds," they say.

3. In "[Conflicts of Interest and Competition in the Mutual Fund Industry](#)," Ajay Khorana (Georgia Institute of Technology) and Henri Servaes (London Business School) examine how conflicts of interest in the U.S. mutual-fund industry affect competition and investor behaviour (their database covered the period 1979-1998). Overall, their paper "highlights a number of conflicts between fund families and investors," say the authors.



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For example, they found “no evidence that investors derive any benefit” from annual fees for marketing and distribution (12b-1 fees in the U.S). Furthermore, “fund families generally want to maximize assets under management ... and the resulting management fees,” an objective at odds with investors’ “desire for high risk-adjusted performance at low cost.”

If financial advisers provide questionable value according to scholarly studies, investors need to manage their investments themselves, suggest a number of observers. A “hands-on approach” need not require any real expertise in picking stocks and managing portfolios nor would it demand hours of laborious research — as long as one adopts the passive approach to investing using index funds and/or exchange-traded funds.

As the creators of MoneySense’s [Couch Potato Portfolio](#) have said for years now, buying and holding low-fee index funds and/or exchange-traded funds takes “only 15 minutes a year” and “will beat about 80% of the money managed by professionals.” To see how it works (or for a refresher), visit the MoneySense website and check out their [Couch Potato Portfolio](#) series.

Another website to check out is the [Index Fund Advisers](#) website, which has a good overview (although it hosted by a seller of a particular kind of index fund). David Swensen’s book, *Unconventional Success: A Fundamental Approach to Personal Investment*, is also a good guide to the approach.

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