



# BEWARE **FREE!**

Recently there has been a lot of noise being made by some of the major discount brokerage firms as they have been racing each other to reach ‘free’ or ‘zero commission’ equity trading commissions for their customers.

Among many words of wisdom I learned growing up on our family farm, the phrase “if it looks too good to be true, it probably is” rings with deafening effect as I read the news about this competition to reach “zero”. Before you become tempted by this gimmick, sit back with your favorite adult beverage and let’s contemplate the concept.

My mind skips from the words of wisdom referenced above to a conversation I had with my son and some of his college friends when they were at our home well-prior to the 2016 Elections. As we gathered around our kitchen island, I asked if they were going to vote in the

upcoming primaries and subsequent election and was pleased to hear each enthusiastically claim that they would. I then learned that they favored a candidate who promised them “free” college. Knowing that they were each working to help pay for school, the allure of a “free” education was easy to be sympathetic towards. I then asked them how “free” college would be possible and got blank looks. I asked them if they thought their professors were teaching just out of the kindness of their hearts or if they were also getting paid and they confirmed that they were compensated for their work. I then repeated the same line of questioning as it applied to those who worked in the library, administrative offices, athletic

department, campus security, and grounds/maintenance and they were quite sure that all were compensated for their work. "How, then, could this all be 'free' to the students?", I asked. We decided that there were very real costs associated with a higher education and that should their candidate get elected these costs would merely be repackaged and paid for in another fashion.

This brings us back to "free" equity trades. The truth is that there are real costs to trading all securities as it is a complex business with many moving parts and, at least in the US, subject to extensive regulatory oversight. The reality is that for the aforementioned firms these costs have been repackaged and paid for in another fashion. Here are just two common methods of cost-shifting that often occur and which can generate significant revenues for these firms:

1. It is common that these firms no longer offer competitive money market funds for cash "sweep" activity in their discount brokerage accounts but rather allow those funds to sit as cash reserves which typically pay a much lower yield to the investor. For example, a money market fund that a firm is not taking compensation from may yield 2%. Meanwhile, popular discount brokerage firms may only be paying as little as .01% on that balance, or 1/100th of 1%.
2. Trade execution is another area that most investors don't think about but which you should be aware of. Many firms route their trades through wholesale trading firms that will pay them for "trade flow" which results in an additional revenue stream for the firm. This method of executing trades may result in worse trade execution—another 'hidden cost' investors should be aware of.

These are just two examples of methods used that result in the investor incurring costs that they may not be fully aware of. Think I may be overstating the sleight of hand that is occurring? Go online and look at the home offices of these firms. These impressive facilities were not built for free.

For additional insights, reach out to your financial advisor. For a second opinion, my team is a phone call away.

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