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Say Goodbye to the 1% Investment-Adviser Fee?

Investors who don't want to pay the traditional 1% of assets for financial advice have an increasing number of alternatives

By Neal Templin

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Keith Rudman used to pay hundreds of thousands of dollars annually to an adviser who charged him a fee on managed assets.

Four years ago, the 62-year-old North Carolina resident got rid of the money manager and moved his eight-figure taxable portfolio into passive investments. Mr. Rudman now uses a planning firm that charges by the hour for advice on everything from tax-loss harvesting of investments to estate planning.

"They're providing a ton more services than my old financial advisers and they're charging me between a 10th and a 20th as much," he says.

Mr. Rudman is among investors who are seeking—and finding—alternatives to traditional financial advisers who charge a certain percentage of assets under management. Even as commissions on mutual funds and trading fees have dropped in recent years, the fees that registered investment advisers charge on portfolio balances have edged up. The average investor with \$750,000 paid 1.04% of invested assets in fees in 2020, up from 1.02% in 2015, according to Cerulli Associates, a research and consulting firm. Meanwhile, an investor with \$10 million paid 0.62%, up from 0.54%.

The growing alternatives come as many experts are predicting lower market returns after years of soaring stock and bond prices. Morningstar Investment Management forecasts that U.S. stocks will average just 1.3% annual returns over the next decade, while domestic bonds will return 1.8%. Other analysts are more optimistic, but hardly anyone sees

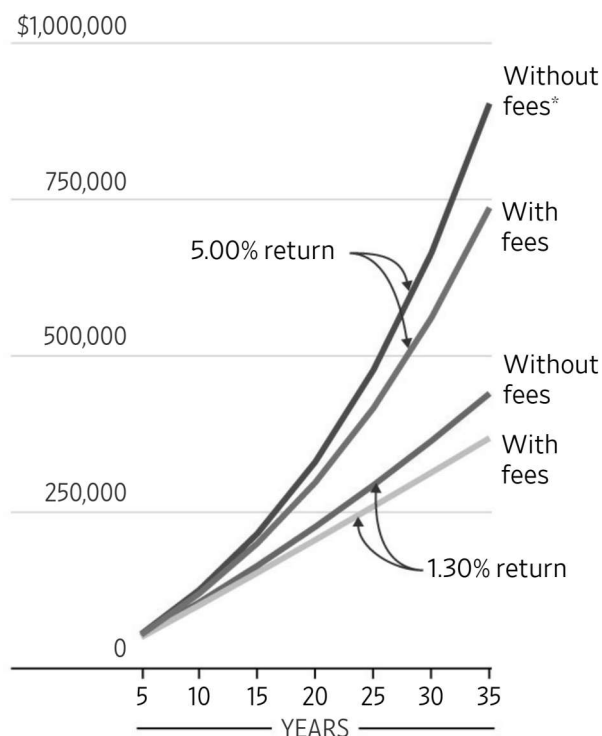
markets doing as well as they have done in recent years. Stocks returned 14.7% annually and bonds 3.4% in the 10 years ended June 30.

When a portfolio is rising by double digits, a 1% fee might seem less significant, though it still takes a toll on portfolio growth. But in a lower-return environment, fees consume a bigger portion of gains.

Suppose stocks rise only 1.3% a year for the next decade, as Morningstar Investment is projecting. If you invest \$10,000 a year, you will have \$106,057 after 10 years, according to a calculation by Moshe Milevsky, a finance professor at Toronto's York University. If you pay a 1% annual fee, you'll have \$101,361. The fees have eaten up almost all your income.

The Burden of Fees

The effect of adviser fees on returns from \$10,000 saved and invested every year over 35 years.



*Assumed 1.00% fee

Source: Prof. Moshe Milevsky of York University, Toronto

Even if you assume a better return, fees still take a toll. If you invest \$10,000 a year for 35 years and earn 5% a year, you will have \$903,203, Dr. Milevsky calculates. If you pay a 1% annual fee on that same investment, you'll only have \$736,522.

“The arithmetic of the investment fees in a low-return environment can be devastating to the nest egg,” Dr. Milevsky says.

Advisers charging 1% counter that their fees are worth it for investors who want or need a high level of service. Milo Benningfield of San Francisco views himself as far more than an asset manager, saying he immerses himself in his clients' financial lives. For example, he says he found a much cheaper reverse mortgage for one and secured a special loan for another so he wouldn't have to sell stocks and pay capital-gains taxes.

His three-person firm has only 48 families as clients, and he says that he regularly tells potential customers to seek out cheaper advice if their financial situation isn't complex enough to merit the fees he charges.

"I have no qualms over the amount of fees and the value we're delivering," says Mr. Benningfield, who charges 1% of assets for the first \$3 million but offers significant price breaks above that level. His biggest client has about \$15 million in assets and pays an average fee of 0.55%.

In the end, how consumers choose to pay for financial advice has big implications. Cerulli Associates estimates that up to \$70 trillion in wealth will be transferred over the next 25 years to heirs and charity. Much of it will go to the same younger generation that is embracing newer options—including advisers who charge flat annual or monthly fees and robo advisers that manage portfolios with computer algorithms.

Here's a closer look at some of those options:

Flat annual fees

Paying a set fee—whatever the size of the portfolio—makes the most sense for people with large balances. Consider an investor with \$10 million in assets who is paying \$60,000 a year in fees. Is it six times as much work to manage that portfolio versus someone with \$1 million who is paying \$10,000 a year in fees?

"We picked up clients of advisers who were paying between \$40,000 and \$60,000 a year, and realized it was insane," says Jay Franklin, chief investment officer of Irvine, Calif.-based Clarity Capital Advisors, which charges a flat fee of \$7,500 annually.

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How do you think financial advisers should be paid? Join the conversation below.

Wedmont Private Capital, a West Chester, Pa., firm that launched in January 2020, charges \$10,000 a year. Co-founder James Pelletier says he uses the same investing tactics at Wedmont that he used at a previous employer charging 1%. For example, Wedmont uses a technique called direct indexing for its clients to create additional tax losses. Instead of putting all their money in passive indexes, it invests in companies that duplicate an index, which allows clients to claim losses on certain stocks even as other stocks are rising.

George Miller, who formerly owned a technology business, moved his money to Wedmont last year. The Philadelphia resident says he is paying a fraction of what he paid previously. And when he inherited some money and suggested that Wedmont manage it for him, he says Mr. Pelletier told him to keep it and defer claiming Social Security to get a bigger benefit.

“I’m pretty sure any other money manager would have said, ‘Give us the money,’ because they would make more money,” Mr. Miller says.

Monthly/hourly fees

Some advisers offer planning advice for a monthly fee, and many target younger investors who haven’t yet amassed wealth.

Chad Holmes, based in Montgomery, Ala., charges his clients between \$300 and \$1,000 a month, basing his fees on both the complexity of the clients’ finances and their net worth. Some investors come to him because they don’t have sizable assets to manage and can’t find a traditional adviser willing to take them on as a client, he says. Others use him because they can save money. He says his biggest client has \$5 million in net worth and pays \$1,000 a month, a fraction of the cost of a traditional adviser.

Lisa Hanshew, a 59-year-old Little Rock, Ark., business owner, pays Mr. Holmes \$372 a month. Among other things, Mr. Holmes helped Ms. Hanshew and her husband figure out estate plans, as well as which debts to pay off first. He also helped Ms. Hanshew set up a savings program so she can retire at age 65.

“He has kept us on track with our budgets,” she says. “I needed guidance from someone I trusted.”

There also are advisers who separate money management from advice. Timothy Financial, the company used by Mr. Rudman, the North Carolina investor, charges like a law firm. Customers of the Wheaton, Ill., company pay \$450 an hour for the most experienced adviser, firm founder Mark Berg, but \$300 an hour for a less senior planner. Clients retain custody and control of their assets, though Timothy Financial will walk them through trades.

“We don’t care if someone comes in with \$100 million or \$100,000,” says Mr. Berg, who started in 2000 by himself and now has 14 employees and 600 customers. “We’re charging for our time.”

Discounted fees on assets

Another approach is to retain fees on assets but sharply discount them. Mutual-fund giant Vanguard Group charges a maximum of 0.3% of assets to have an adviser manage a client’s money. Robo advisers like Betterment or Wealthfront charge just 0.25% to manage portfolios with computer algorithms. Vanguard two years ago started its own robo adviser, charging 0.15% of assets.

Vanguard has attracted \$243 billion in assets to its six-year-old discounted personal-finance service. It charges 0.3% of assets annually on the first \$5 million, but just 0.05% above \$25 million.

Clients need a minimum balance of \$50,000 to get the service. They have unlimited access to an adviser, though only those with more than \$500,000 under management get a dedicated adviser. Investors with less assets are assigned to a team.

Robo advisers, meanwhile, manage money with increasingly sophisticated computer algorithms. Wealthfront has algorithms that do tax-loss harvesting and direct indexing, among other things.

Robo advisers aren’t for investors who need hand-holding. “When somebody does call or email us, we look at that as a failure of the service,” says Kate Wauck, Wealthfront vice president of communications.

Even clients who want full service can still save by shopping around. Susan Elser of Indianapolis is a traditional adviser who helps her clients on all their financial decisions.

She charges 0.65% on the first \$2 million in assets under management and 0.35% on anything over \$5 million with a graduating scale in between.

“Every time I meet an adviser who charges 1% and ask why, they say that’s the going rate,” she says. “I tell them they need a better answer.”

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