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How to know when your adviser is behaving badly

By JOHN HEINZL

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Good financial advisers can provide a lot of value. They can hold your hand during market slumps, keep you focused on the long run and – if they have the proper credentials – offer retirement, tax and other financial planning advice that goes well beyond the selection of stocks or funds.

But a bad adviser can do a great deal of damage to your financial – and emotional – health. If you work with an adviser, as many investors do, it's imperative that you play an active role in the relationship so that you are getting value for your money and protecting yourself from potential harm.

Make no mistake: There are unethical advisers out there who prey upon people's ignorance and trust. If you fail to educate yourself, you risk becoming a victim. The consequences can range from suffering subpar returns to losing your life savings, your home or your marriage.

Don't believe it? I encourage you to read *The Naked Investor* by John Lawrence Reynolds for some sad and shocking examples. Or go online and watch the recent CBC *Marketplace* hidden-camera episode, *Show Me the Money.*

Here's what William Bernstein, author of *The Investor's Manifesto*, has to say:

"Who can you trust? Almost no one ... You are engaged in a life-and-death struggle with the financial services industry. Every dollar in fees, expenses and spreads you pay them comes directly out of your pocket."

Here are some red flags to watch out for.

Pushing investment loans

This is one of the most common ways for advisers to quickly build their books. They'll dazzle you with slick charts that show borrowing can improve your performance, but what they won't necessarily tell you is that leverage also magnifies losses and can wreak havoc on your financial and emotional well-being.

In a February notice, the Investment Industry Regulatory Organization of Canada (IIROC) said it "has found an increasing number of cases where inappropriate borrowing-to-invest strategies are being used by clients" and noted "several situations where clients were not provided with sufficient information to properly understand the risks ..."

Here's my rule about borrowing to invest: Don't.

Not disclosing returns or fees clearly

As an investor, you are entitled to know how well your portfolio is performing relative to an appropriate benchmark such as the S&P/TSX composite index. You are also entitled to know how much you are paying in fees every year.

If your adviser balks when you ask for these numbers, it's time to shop around.

Fortune-telling

If your adviser claims to know how much the market will rise this year or what will happen to the price of gold or oil, that's a bad sign. Nobody knows. An honest adviser will admit that markets are unpredictable and that stocks can struggle for years at a time even as they rise over the long run.

Pushing junk

Some unscrupulous brokers will stuff client accounts with new issues that pay them fat commissions, but which carry excessive risk. Structured products – such as principal-protected notes – are another money-maker for brokers.

Before you invest in anything, insist that your broker discloses, in writing, the commission he is being paid. Better yet, avoid any product that you don't understand or relies on a seductive "story."

Sticking with blue-chip stocks or index-tracking funds is often the best course of action.

Trading excessively

If your adviser earns commissions when you trade, don't be surprised if he comes up with lots of justifications for doing just that. He might encourage you to sell one bank and buy another, for example, or trim your pipelines and put the proceeds into an energy producer.

Instead of constantly trading for the adviser's benefit, most investors would be much better off simply buying and holding blue-chip companies whose revenues, earnings and dividends rise gradually over time.

This is just a partial list of the adviser behaviours that can signal trouble. The more you learn about investing, the better able you will be to know if your adviser is acting in your best interest. If you suspect that's not the case, it may be time to search for a new adviser or consider looking after your own investments.