

>: Brokers vs. Newsletters (Part 1)

Tuesday, August 28, 2007 / Jason Jovine

Hey, Tycoon reader, yeah I'm talking to you. It's **Jason Jovine** here. No, you're not schizophrenic (I think). You are really hearing my voice in your ear. I want to ask you a question:

Where do you get your investment/trading advice from?

More importantly, since we can't cry over spilled milk, where will you get it from? No, really, this is a very serious question. Who will you trust to tell you where to put your money? Er, WHOM will you trust?

I will tell you what an ex-girlfriend told me to do a while back when making a decision. She told me to do a "PMI" (Pluses, minuses, and interesting). In other words, figure out the pros and the cons of each decision, and then do what is best for you. Let me break it down for you.

Brokers (i.e., Financial Consultants)

PROS

1. You have someone to yell at and blame when your stocks are down. Since they are the ones who probably gave you the idea, you can "hold them accountable," so to speak.
2. You have someone to hold your hand and keep things in perspective for you. In other words, a good broker probably has years of experience, and when you are having that "anxiety attack" when the market goes down 200 or 300 points, he or she can help you keep things in perspective and prevent you from making stupid mistakes.
3. If you have an account with a broker, this person, of course, works for a brokerage firm, and that firm may have many good products and services (e.g. hot IPOs) that you would only be able to get by having an account with a broker there. Brokers usually take the best care of their best clients. In other words, if you have a nice amount of money with that broker relative to the other accounts that he manages, he will probably try harder to get you some of the good products that the firm comes out with.
4. You have someone to help educate you. A good broker, like a good doctor or anyone else who is a true professional, will take the time to help you understand what is going on instead of just giving you short, meaningless answers. What you learn from a good broker will stay with you for the rest of your life.
5. A broker could fight to get you better prices (i.e. executions) on trades. In other words, a good broker will act as an advocate for you and will fight to get you the best price possible on the stock, ETF, or any other trade or investment that you make.

CONS

1. A broker can charge you an arm and a leg. Theoretically speaking, a broker is "allowed" to charge you up to 5% of the contemporaneous cost of a transaction.

In other words, if you buy 1,000 shares of a \$10 stock, a broker theoretically can charge you up to \$500 for this trade (5% * \$10,000). When I say "contemporaneous," I mean that the 5% is on the overall trade. In other words, if you sell \$10,000 worth of stock through your broker, and he puts that \$10,000 into another stock on the same day, he can charge you up to \$500 (5%) in total.

Maybe he will charge you \$250 on the sell and another \$250 on the buy. Or maybe he will charge you \$500 on the buy and nothing on the sell. This is his call, but he can not exceed 5% on that \$10,000 wherever the money goes on that particular day.

This 5% rule is more of a guideline than a strict rule, but rest assured that brokers do not dare cross it (smart ones, at least) because they do not want regulators looking too closely at them.

2. A broker's motives may not be the same as yours. A broker may be pushing his firm's inventory to you just to get a commission when there may have been a better place for you to put your money.

He may "churn" your account. 'Churn' means that he may trade just for the sake of trading to generate a commission. This is, of course, if your account is set up to be transactional in nature. In other words, if the broker only gets paid to buy and sell. This is where he may have an incentive to trade unnecessarily.

If it is a "wrap account", then your account may just collect dust because he gets paid a percentage on your account every year no matter what

happens. So why should he try to stress himself out to get you the higher returns? The work that this would require from him is not worth it to him.

The best advice that I could give you is to set your account up as a ?hybrid? (part wrap and part transactional in nature). The percentage that goes into which type depends on your own unique needs. As always, make sure to ask questions often, and stay on top of your account. No one cares about your money as much as you do.

3. Brokers, especially at ?wire houses? (e.g. Merrill Lynch) have their hands tied to a certain extent. These firms have so many rules and regulations regarding how these brokers can trade their clients' money that they end up just settling for mediocre returns.

In other words, many firms want their brokers to just be ?cogs? in their gigantic money machine. Creativity is stifled in this type of environment, and as a result, your investment returns may suffer.

4. A broker may pressure you to refer him to friends, neighbors, business associates. The hardest part of any business including that of a broker is to get new clients. The broker will argue that the more clients he has, the less time that he needs to be out there looking for new ones and hence could spend more time doing research and other high end tasks so as to produce better returns for his clients (like you).

I don?t think that there is anything wrong with giving him or her referrals after you have been a client for a long time and after he has proven that he is competent and trustworthy.

I remember like it was yesterday a story of a guy who recommended his broker (that he had been with for just two weeks) to his next door neighbor. The broker stole money from both of them, and the next door neighbor ended up suing the guy who recommended the broker to him. SO BE CAREFUL!

I will tell you next week what the pros and cons of using a financial newsletter are, so stay tuned.

Until the next time, folks, spend your hard-earned money wisely.



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