3 Dirty Secrets Your Broker Isn't Telling You

Description

Even though discount brokerages are both common and cheap, certain investors still prefer to go to a full-service stock broker.

These investors prefer the human touch, of course, but it goes further than that. As the account size grows over time, both the investor and advisor benefit. Sure, the broker is generating more in fees, but the investor doesn't mind–as long as the account balance keeps going up.

There's one big drawback to using a broker, and that's the uncertainty of it. Sure, a broker most likely has client interests as a big motivator. But ultimately, they're mostly concerned with themselves and their firm.

Here are three other ways brokers are taking advantage of their smaller clients.

Pushing the latest offering

When Bay Street bankers assist a company with debt or equity financing, it's often in the form of a bought deal. The bank buys up all the shares, ensuring the company gets the full amount. It then sells these shares to big institutional investors, mutual funds, and so on.

Sometimes, there's very little demand for these shares from the big boys. So word goes out to the sales department to get rid of these shares. Often, individual brokers will be assigned a quota of shares they're responsible for selling. They start working the phones, selling this placement to retail investors.

If the smartest investing minds in the business passed on something, why would retail investors be interested? But they remain blissfully unaware as their broker pushes the latest offering.

Is this the kind of thing that is beneficial to one's long-term financial health?

Short-term thinking

If a broker gets paid per transaction, you can bet they're going to encourage investors to trade excessively. That's in their best interest.

Is it in the investors' best interest? I think we all know the answer to that.

There's a reason why Warren Buffett's favourite holding period is forever. The Oracle knows that identifying great companies and holding on to them for a very long time is one of the keys to generating significant long-term wealth.

Say 20 years ago you identified **Royal Bank of Canada** (TSX:RY)(NYSE:RY) as the kind of company you'd like to own over the long term. Even back then the company had a dominant position in the

Canadian banking sector, and although it hadn't yet expanded to the U.S. market, it was pretty obvious that it would eventually outgrow Canada.

If you had put $10,000 in Royal Bank shares back then and reinvested all of the dividends, you'd be sitting on an investment worth nearly $186,000. That's the kind of return that can really make a difference.

If that investment was in a taxable account, you'd be looking at a big tax liability when selling. That's a very powerful reason to keep holding on. Do you think a broker that works on commission would be encouraging someone to be patient or to sell and put the capital somewhere else?

Borrowing to invest

I'm constantly amazed at how many investors have been convinced to borrow extra money to throw at investments.

While this can be a smart move, I really doubt it'll work for most for a couple of reasons. The first is the cost. When you're paying 3% or 4% for margin, it's hard to get ahead. That's a big chunk of potential returns right there.

The other reason is that investors are crummy at timing. Many borrow to invest when markets are high, which is the wrong time to do it. This inevitably leads to losses that are exacerbated because of the addition of borrowed money.

The bottom line

Brokers do have some value. They can be a voice of reason during tough markets and can help out folks who would like to get into individual stocks but just don't have the ability to properly analyze a potential investment.

But at the same time, there's a lot they don't tell investors. Which is why here at Motley Fool Canada, we feel you're better off without them. With our help, you can really supercharge your returns.

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Date
2025/07/07
Date Created
2016/10/07
Author
nelsonpsmith