Revealed: 3 Dirty Secrets Your Broker Doesn't Want You to Know

Description

The financial services industry has done a terrific job convincing investors they have our backs.

The truth is far more complicated. Yes, financial advisors and stock brokers do benefit from additional assets under management. After all, many get compensated as a percentage of assets. But they'd much rather spend their time trying to drum up new business.

Say your financial advisor works hard and gets you an extra 2% per year in annual returns. You'd definitely end up richer at the end of your investing lifetime, and an advisor paid on a percentage of assets would get make more too. But the potential reward for the advisor is far less than the reward for an investor.

Here are three other important secrets your broker is keeping from you.

IPOs stink

Study after study has confirmed it. The average IPO underperforms in its first few years as a publicly traded company.

It makes sense if you think about the IPO process. There's so much private equity and venture capital money out there today that a stock only debuts on the stock market for two reasons. The first is so other investors — including employees with a lot of accumulated stock — can cash out. The other reason is so the company has raise money at the highest multiple possible.

The IPO process is also great at stirring up interest. Smart underwriters will play investors against each other to help their clients get the highest price possible. The IPO is usually accompanied with the underwriter's analysts coming out with bullish research reports. Everything points to what a great buy the new issue is.

And then many of those IPOs get pushed to retail investors, especially the really crummy ones the smart money avoided.

At the end of the day, many IPOs are nothing but a giant conflict of interest that usually end up with investors getting poorer. Of course, the exceptions are lucrative enough to keep many of us crawling back.

Say no to (most) funds

There are thousands of mutual funds and hundreds of exchange-traded funds out there, each with their own unique features. Many retail investors just don't have the tools needed to properly analyze each.

Many of these investors will then turn to a financial advisor to help them navigate this world. Many brokers will then suggest funds with huge fees, knowing the customer is likely to say yes simply to get the whole process over with.

The kinds of funds you should be buying are rarely pushed by a broker. An investor can invest in the **iShares S&P/TSX 60 Index Fund** (TSX:XIU) and pay a management fee of just 0.18%. Compare that to the average mutual fund, which charges fees close to 2%.

Buy and hold

Many stock brokers get paid a commission every time a client trades. Naturally, they will likely recommend a lot of buys and sells.

Yet it's been proven one of the easiest ways to invest your way towards financial freedom is to buy great companies — preferably those that pay a dividend — and hold them for a very long time.

Take **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) as an example. The owner of nearly $60 billion worth of assets — consisting of oil and natural gas pipeline assets as well as 11,000 megawatts of power-generation capacity — has been a fantastic investment over the last 20 years.

Including reinvested dividends, shares have increased 9.16% annually since 1997. It's enough to turn a $10,000 original investment into one worth $57,755 today.

Another terrific investment over time has been **Bank of Montreal** (TSX:BMO)(NYSE:BMO). Sure, BMO is one of the smaller members of the so-called Big Five, but it has done a nice job maintaining its market share in Canada and expanding into the United States.

BMO has outperformed TransCanada over the last 20 years; shares have increased 11.6% annually including reinvested dividends. A $10,000 investment made in 1997 would be worth $89,977 today.

The bottom line

I don't want to paint all brokers with the same brush. Some care deeply about their clients and only do what's right. But many others don't. They view their customers as nothing more than a profit centre.

The way to invest is simple. Just buy great companies and hold them over the long term. We can help.

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