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YOUR MONEY

Is Your Financial Adviser Acting in Your Best Interest?

Wealth Matters

By PAUL SULLIVAN FEB. 10, 2017

This is a tale of two mutual funds with abysmal performance — but very different reactions from their investors to their returns.

The Ivy Asset Strategy — which is known as a total return fund, because it tries to maximize gains through a variety of investment strategies — ranked in the 99th percentile in 2016, according to Morningstar, meaning that investors could scarcely do worse.

The Waddell & Reed Asset Strategy, also a total return fund, ranked in the 97th percentile in the same class.

But last year, the Ivy fund lost 65 percent of its assets — meaning that investors pulled out — while the Waddell & Reed fund lost only 26 percent. Over the last three years, the Ivy fund has lost 82 percent, compared with 41 percent for the Waddell & Reed fund.

Given that both funds come from the same family — the Ivy fund is a product of Waddell & Reed, and they have the same portfolio managers — it might seem to be a curious question why one dysfunctional family member is being battered more than another.

The answer, however, is in plain sight, and of importance to investors: The Waddell & Reed version is sold by Waddell & Reed representatives to their financial advice clients. The Ivy fund can be bought by anyone — and those independent advisers seem to have told their clients to get out of it.

The discrepancy goes to the heart of the so-called fiduciary rule, which is supposed to take effect in April for retirement assets unless the Trump administration succeeds in blocking it. Under the rule, financial advisers would be required to act in the best interests of their clients' retirement accounts, not their employers' bottom lines.

Roger Hoadley, the director of communications for both the Ivy and Waddell & Reed funds, does not dispute the premise that investors pulled out of the former more than the latter because of how their advisers may have steered them. "Those are two funds managed very similarly, just distributed differently," he wrote in an email response to questions. "So, the same portfolio manager(s) in each case, almost identical holdings, though there may be slight differences."

"The Waddell & Reed Advisors funds are offered by the Waddell & Reed Inc. broker/dealer," he added. "The Ivy Funds are offered widely" through registered investment advisers, wirehouse brokers and others.

The reason that some investors would be told to sell shares in a poorly performing fund — while others wouldn't — can be traced to the two different standards of care in the financial advice world.

The standard of "suitability" guides most brokers and registered representatives, like those at Waddell & Reed, and means they will pick an investment that is suitable for you. The fiduciary standard binds an adviser to work in your best financial interests — and also includes lawyers, certified public accountants and brokers with certain designations, like the chartered financial analyst designation, who have ethical obligations. If the distinction seems subtle, the outcomes aren't always.

Last week, President Trump made an announcement that gave the Labor Department discretion over whether to replace the suitability standard with the

fiduciary obligation on retirement assets. The change had been debated for six years and was about to be put in place, but now it may be revised or scrapped entirely.

The debate on these two standards brings up an age old-question: How can anyone find an adviser who is going to counsel them on investing their money for the long haul?

“If you’re working with a broker or registered investment adviser, if there’s a brand on their card and the brand of investment they’re recommending matches that, I’d have very heightened awareness and I’d ask a lot more questions,” said Mark Cortazzo, a senior partner at the Macro Consulting Group, an independent adviser.

The Waddell & Reed/Ivy situation is stark, but it’s not the only one at those sister funds. The Waddell & Reed Science and Technology Fund ranked in the 92nd percentile for such funds and had outflows of just 8.5 percent last year. The same fund through Ivy Investments had a loss of 39.1 percent of its assets in 2016.

Other companies have similar issues. While the MassMutual Financial Group is well known for insurance, its agents also sell financial products. Its Premier Strategic Emerging Markets Fund ranked in the 63rd percentile for similar funds, yet in 2016 its assets increased by 3.7 percent in 2016.

OppenheimerFunds, which is owned by MassMutual, offers the same fund with the same managers to its broader range of clients. Given its middling performance among emerging markets funds, its assets fell by 6.4 percent.

More starkly, over a three-year period during which the funds ranked in the bottom quartile, the MassMutual version’s assets rose by 65 percent, while the Oppenheimer one lost 15 percent of its assets, as investors and advisers outside of the MassMutual network voted with their dollars.

“Asset flows are driven by a number of factors, including the end investor and their investment goals and time horizon,” said Natalie Marin, a spokeswoman for Oppenheimer. How those funds are marketed and sold to investors also factors into how money goes into and out of the funds, she added.

To be fair, it's easy to see the differences with these funds. Most fund manufacturers that also have wealth management divisions have stopped giving the internal and external funds different names. When all money is commingled, it's harder to tell what money was put there by internal advisers and what came from outside.

One way, of course, is the occasional lawsuit, as happened with JPMorgan Chase, which was fined $307 million in 2015 for steering customers to its own funds and products. The regulators showed that in addition to funneling more fees to the asset management division, the advisers also at times put clients into more expensive JPMorgan products when the firm had a less expensive version of the same thing.

"Most people would have no way of knowing if it was a conflict," Mr. Cortazzo said. "You see a lot of their own brand, a lot of not the cheapest stuff you can buy. We see these conflicts."

Of course in some cases, clients don't have the opportunity to think something could be wrong. Investments get chosen for them because they are in a discretionary account, even though those investments may not have been selected to minimize fees.

Fidelity Investments, the mutual fund giant, has a series of funds just for clients of its portfolio advisory service. They are called Strategic Advisers funds and open only to people who use Fidelity to manage their money.

"As an investor, you don't choose that fund," Nicole Goodnow, a Fidelity spokeswoman, said. "It's not like an investor comes and says, 'I want that income opportunity fund to be part of my portfolio.' The manager says, 'We think you'd be a fit for this fund.' "

And that can be a problem.

Take the Strategic Advisers Income Opportunities Fund. It gained 13.54 percent in 2016, which put its return slightly above the average for similar funds in its

category. But the fund had three of its largest investments in Fidelity funds, including its largest position — 18.48 percent in the Fidelity Capital & Income fund.

This Strategic Advisers fund also had large holdings in the more expensive A shares of several funds instead of the cheaper institutional class. The difference sounds like inside baseball, given that the differences are fractions of a percent. But in a low-return environment, those fractions matter, particularly when it is easy to switch from A shares to institutional shares without incurring a tax bill.

"People are all so good now, so it all comes down to fees: Do we expect to get value in excess of what we're paying?" said Gary Ribe, chief investment officer of the Macro Consulting Group.

The hunt for fees hiding in plain sight — particularly when investors think a provider is acting in their best interest — is continuing, exhaustive and dispiriting.

Even advisers who act under the fiduciary standard can receive so-called soft dollars from the custodian holding their clients' money or from mutual funds or exchange-traded funds that want to encourage them to sell more of their fund. The fund may be ideal for clients, but it is the appearance of conflict that calls into question the adviser's motives.

So what should people do? The advice, short of enforceable regulation and industry change, puts the onus on the individual.

Michael Krol, chief client service officer at Waldron Private Wealth, which manages $1.4 billion, said that clients needed to hear their advisers say: "This is the fee you pay me, and none of the advice I give you, none of the products I put you into, are going to result in any greater compensation to me."

"If the client knows there is no way for me to get paid more," Mr. Krol added, "that's a simple way to avoid that conflict."

That can work fine at a brokerage firm guided by the less rigorous suitability standard. "If we happen to engage someone on the brokerage side of the business, I'm very comfortable disclosing how product vendors compensate us," said Jimmy Lee, chief executive of the Wealth Consulting Group, which is a hybrid adviser and

broker through LPL Financial. “I tell them what the commissions are directly from product vendors, and I say the broker-dealer gets a part of the commission that is passed on to us as a registered representative.”

But at the end of the day, fiduciary standard or not, investors are going to need to look more closely at what they own and why they continue to own it.

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