

Are Your Assets Costing You Money? **By Steve Braun**

Financial advisers don't work for free. Clients understand this and don't mind paying reasonable fees for services rendered. The structure of those fees and the manner in which they are paid, however, can have a significant impact on the advice clients receive and on their pocketbooks.

There are two basic fee structures used by most "fee-only" financial advisers:

- **Asset Management Fees** – charging a percentage of the assets under management
- **Hourly Rate** – charging per hour of work

It is estimated that 95% of all "fee-only" financial advisers use the annual asset management fee structure for compensation and here's why.

Asset Management Fees: The Cost

Annual asset management fees vary from 0.5% to 3.0% of assets under management, but typically average in the 1.0% to 2.0% range. The following table outlines the costs of these fees (in parentheses):

Annual Asset Management Fees Paid				
Asset Value	<u>\$100,000</u>	<u>\$250,000</u>	<u>\$500,000</u>	<u>\$1,000,000</u>
1% Fee	(\$1,000)	(\$2,500)	(\$5,000)	(\$10,000)
2% Fee	(\$2,000)	(\$5,000)	(\$10,000)	(\$20,000)

Asset Management Fees: The Devastating Impact

These fees are paid every year. Think about the devastating impact on your overall wealth.

- **Example #1** - Let's say you have \$500,000 in assets and are paying \$5,000 per year in asset management fees (at a 1% rate). You are also contributing the maximum amount to a Roth IRA for you and your spouse (that's \$3,000 each for a total of \$6,000 in 2003). That means you are essentially suffering a staggering 83.3% loss on your Roth IRA contributions (\$5,000/\$6,000). How long can you afford to do that?
- **Example #2** - Let's say you have \$250,000 in assets and you are paying \$5,000 per year in asset management fees (at a 2% rate). You are also contributing \$10,000 each year to your 401-k plan. That means you are essentially suffering a 50% loss on your annual 401-k contributions (\$5,000/\$10,000). Even the 1% fee will cost you \$2,500 or a 25% loss on your annual contributions. Is that what you're working hard to save for?
- **Example #3** - Let's say you are a recent retiree looking forward to the good life. You're not super-rich but you're not hurting either. You're wondering whether or not you'll have enough

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money to survive a long life without scrimping on your lifestyle. How much can you safely spend each year? Here's the conventional wisdom:

The normal threshold for retirement spending is typically 4% of your accumulated assets. That is, under most scenarios you can safely spend 4% of your accumulated assets and not go broke before you die (depending on your longevity, rate of inflation, and investment returns, etc.). If you spend anything over 4%, you increase the odds of going broke before you die. Anything less than 4% is considered pretty safe.

So, if you are paying 1% in annual asset management fees to your financial adviser, you are effectively giving up 25% of your wiggle room to stay under the 4% threshold. That is, your spending threshold is lowered to 3%. Does it make sense to do that?

- **Example #4** - Finally, consider how asset management fees devastate your portfolio over the long-term. The table below details the impact of annual asset management fees over a 30-year period (in parentheses), based on average annual rates of return of 6%, 8%, and 10% in a tax-deferred account.

Long-Term Asset Management Fee Impact			
Annual Fees	6%	8%	10%
\$2,500	(\$209,504)	(\$305,866)	(\$452,360)
\$5,000	(\$419,008)	(\$611,730)	(\$904,718)

If you are paying just \$2,500 in asset management fees every year for 30 years, it will cost you \$452,360 at an average annual return of 10% over that time. That's a lot of retirement money to give up. Is the advice and service you receive from your financial adviser going to be able to replace that money?

How Can You Avoid These Extraordinary Costs?

At Liberty Financial Planning, we believe that compensation based on an hourly rate for services rendered is just more sensible for clients because it saves them money versus the traditional commission-based or asset management fee structures. You keep more of your hard earned money working for you.

What's in it for us? Happy clients like you keep more of your hard earned money working for you. We figure you'll tell your friends, family, and business associates about our professional service and unbiased advice. That's how our business grows!

Give Liberty Financial Planning a call today for a free initial consultation to see how we can help you.

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