What to look for when selecting a good investment advisor

An investment advisor should hold a valid license issued by the Securities and Exchange Commission of Sri Lanka (SEC).

"If you have knowledge, let others light their candles with it."- Winston Churchill

It is important to deal with a licensed investment advisor as such advisors are given a special training on the industry. The license is issued after the successful completion of a course that entails both theory and experience. Further on, the license is renewed periodically based on their expertise and knowledge.

When you contact an advisor make a kind request for him to show a copy of his license and inquire if it was renewed.

It is better to verify the details given by the advisor. The SEC will assist you in verifying the details.

An investment advisor should be knowledgeable.

"An investment in knowledge pays the best interest"- Benjamin Franklin

This characteristic is strongly linked with the above stated. A licensed investment advisor should be backed by wide knowledge (current events, politics etc.) as the performance of the equity market and listed companies are influenced by factors that are not limited to the capital market. For an example the political crisis in the Middle East would have an adverse impact on the performance of oil companies that are listed.

You should find an investment advisor with experience and knowledge to give you the level of service you are looking for.

The only way one could test the knowledge is by questioning the advisor. It will enable you to evaluate the competency of the advisor in managing your portfolio. Another good yard stick would be to infer into his educational background. Most investment advisors in Sri Lanka are graduates.

We live in a rapidly changing world and these changes could influence investment decisions. A successful advisor will have the thirst to follow up on such changes.

An investment advisor should act with utmost integrity.

"The glue that holds all relationships together is trust. Trust is based on integrity" - Brian Tracy

Investing in the capital market is strengthened by the financial relationship between the advisor and the investor because in most cases clients invest based on the recommendations given by their advisor. Thus integrity can be considered as the most important characteristic of a stock broker.

They should always talk of both the risk and benefit of investing in a particular stock. Advisors should explain to their clients that the market does not generate abnormal profits overnight or within a short period.

They are not expected to divulge information about their client's portfolio or investment decisions to other clients. If an advisor tries to share such information with you for the purpose of giving you an investment tip bear in mind that there is a possibility of him sharing your personal information with another.

Honest licensed investment advisors will always put the needs of the client before their own needs. Yet we should bear in mind that they represent a company with a profit motive and is bound to generate business through the brokerage fee. Therefore the investors should keep a close track on the transactions they make.

An investment advisor should be disciplined.

"Man must be disciplined, for he is by nature raw and wild." -Immanuel Kant

A stable and growing market brings about ample opportunities. It is not feasible to invest in all these opportunities.

A disciplined advisor will build up goals in relation to a client's portfolio and draw up an investment strategy accordingly. He will use up these opportunities only if they go in line with the client's objectives. He will always encourage a balanced portfolio and will not be overly concerned in giving his clients short term returns that entail a high risk.

Recommendations given by a good investment advisor will always be based on solid reasons/research.

"Research is creating new knowledge." ***-Neil Armstrong***

The recommendations given by an advisor will always be backed by facts and figures to support his argument. It should draw a balance between fundamental and technical analysis.A recommendation should include the aspects addressed below.

- ✓ The risk and benefit of investing in the stock.
- ✓ Financial performance of the company
- ✓ Price movements/trends of the stock
- ✓ Impact of prevailing political, social and technological conditions
- ✓ Impact of expected political , social and technological conditions
- ✓ Comparative analysis in relation to other stocks in the same industry
- ✓ Comparative analysis in relation to other stocks in other industries
- ✓ Evaluate the opportunities and strengths of the sector the stock belongs to
- ✓ The impact of macro economics indicators as inflation, exchange rate etc.
- ✓ The impact of monetary and fiscal policy

When the above stated points are discussed it is easier for the client to judge the reliability of the recommendation.

At times advisors by mistake forget to give out reasons for the recommendations. In such an instance a responsible investor will ask them why they recommend the stock. Never accept advice at face value however convincing it may sound.

Don't forget that your advisor is human and thus by mistake could omit or misinterpret information. Hence always recheck the data and facts presented.

A good advisor will do his homework.

"There are no secrets to success. It is the result of preparation, hard work, and learning from failure." – Colin Powell

Many investors seek the assistance of a stock broker as they don't have the time to carry out the background research required in making an investment decision while some might not have the relevant subject knowledge. In such an instance the advisor should take up this tedious task.

Look out for a person who is hard working and has the inner drive in taking an extra step to serve you better. Think twice before you take the advice of individuals who rely on the homework done by other advisors or investors.

Licensed investment advisors should not engage in unlawful trading practices.

There are certain trading practices that are not allowed in financial markets as it increases market risk and leads to inefficient markets. You should ensure that your money is not diverted towards such trading practices. Be cautious when you deal with advisors who usually engage in such unlawful trading practices. Your money will be more vulnerable towards risk if you trade with such advisors.

A good licensed investment advisor will be patient and always have time for you.

"The problem with communication is the illusion that it has been accomplished"-G.B Shaw

Remember that communication between the investor and advisor is vital. Investors should select an advisor they are most comfortable with.

He will guide you in all your investments and answer your questions regarding your investment. He will listen to your needs and expectations, risk appetite and there after assist you in making your financial plan. At the point of opening an account he would brief you on the terms and conditions of every document you sign. If the client has signed a Discretionary Account (It is an account that gives the advisor the legal authority to trade on behalf of the client.) the licensed investment advisor will constantly inform you of the transactions done on behalf of you. Most of them will call you and update you on your portfolio.

A good licensed investment advisor understands his role.

"Only aim to do your duty, and mankind will give you credit where you fail".-Thomas Jefferson

A licensed advisor's role is to advice the client on various investments while the client holds the liberty to select what he feels is the best. A good advisor will never trade without asking the investor however lucrative an investment opportunity may be.

A good licensed investment advisor will not expose the client's portfolio towards unwanted risk.

"Confronted with challenge to distill the secret of sound investment into three words, we venture the motto, margin of safety"- Benjamin Graham

The risk could be minimized by advisors if they adhere to the following.

1. He will encourage long term investment.

"Buy something that you are perfectly happy to hold if the market is shut down for 10 years."- Warren Buffet.

Investing based on a short term horizon exposes your investment towards unwanted risk as there is greater fluctuation in the short run. Few individuals who act as advisors encourage short term investment as it brings quick returns. Many investors are not in a position to hold the money for a long time frame. The fear of losing the client might result in the advisor encouraging short term investments that may be risky. The ideal would be when a licensed advisor encourages both short and long term investments giving greater weight towards the latter.

2. He will refrain from encouraging you to trade on excessive credit.

"Refrain from over reliance on credit"-Sara Beeny

Credit is money. It should be paid back at some point with an interest. Credit may enable you to increase your profits in a growing market. What happens if the market goes down? There is a possibility of the value of your portfolio decreasing rapidly and after a certain level of exposure your stocks will be sold by the credit provider. You will incur great losses.

Investment advisors should tell their clients not to purchase on excessive credit unless they could afford it. They don't encourage their investors to mortgage their fixed assets to enter the market as the equity market does not bring fixed returns.

3. He will encourage diversification.

“Diversification is the key towards profitable long term investment” – Rogger Gibson

A common trend witnessed in global capital markets is investing all the money in penny stocks that carry a very high risk. A responsible licensed investment advisor will encourage a diversified portfolio. The mix of stocks will be based on the client’s financial goals and risk appetite.

4. He will not recommend stocks based on luck

“Shallow men believe in luck. Strong men believe in cause and effect.” R.W. Emerson

Certain advisors might randomly pick on a stock and advice the client to purchase it. It may be based on pure luck or at times years of experience might enable the advisor to forecast the performance of the stock. Such predictions might come true. It can’t be generalized that these predictions will always come true. A smart licensed advisor will always base his recommendations on facts and figures. Thereby minimize the investor’s risk.

A smart advisor will never promise a fixed return from the market.

“Intellectual brilliance is no guarantee against being dead wrong” Anonymous

The stock market is fuelled by the demand and supply for stocks and thereby cannot reap fixed returns. If one promises a fixed return he is either unaware of the fundamentals of the market or is involved in creating a false demand for the stock. Investors should think twice before they select such an advisor.

Smart advisors will see opportunities in market fluctuations.

"We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful"- Warren Buffet

A far thinking and disciplined investment advisor will not advice the client to invest all the money at once. Instead he will advice to keep a certain portion to be invested when markets are down and thereby increase profits.

A trend witnessed in global markets is to invest when the market is going up. Trading practices of this nature are more prone to risk. When the market is down it presents greater opportunities for investors to make profits.

It is true that you can't grab all the opportunities but it doesn't mean that you leave them out simply because you lack patience and discipline required in trading.

Everything that shines is not gold.

You will come across smart individuals who will promise you high returns. Don't accept anything at face value. Question them based on the yard sticks given above and verify the information with a third party. Making a mistake at the point of selecting your investment advisor might result in financial losses in the years to come. In most cases you will realize it when the damage is already done and there will be no turning back.

"A little neglect may breed great mischief."-Benjamin Franklin