Total Cost of a Financial Advisory Relationship: Trends Over Time

Introduction

Understanding the total cost of a financial advisory relationship requires examining both the advisory fees and the expenses associated with investment products. Over the past few decades, trends indicate a decline in product-related costs, while advisory fees have remained relatively stable or increased. This report explores these trends using primary research data, including advisory fees, investment product expenses, and their aggregate impact.

1. Advisory Fees

Stability and Increases:
Research indicates that advisory fees, particularly those based on assets under management (AUM), have remained stable over time. In some cases, these fees have even increased. For example, a study found that the median standalone financial planning fee rose by 12%, and retainer fees increased by 25% over a two-year period.[1]

Fee Structures:
Advisors typically employ tiered fee structures, charging a percentage of AUM that decreases as asset levels rise. For example, a common fee might be 1-1.25% for the first $2 million of assets, with a lower percentage applied to amounts above that threshold.[2]

2. Investment Product Costs

Declining Expense Ratios:
The costs associated with investment products, such as mutual funds, have significantly declined. From 1996 to 2023, the asset-weighted average expense ratio for equity mutual funds decreased from 1.04% to 0.42%.[3] Similar trends are observed in hybrid and bond mutual funds.

Shift to Low-Cost Funds:
Investors have increasingly favored no-load funds without 12b-1 fees, which often come with lower expense ratios. In 2021, 89% of gross sales of long-term mutual funds were directed toward these no-load funds, up from 46% in 2000.[4]

Separately Managed Accounts (SMAs):
SMAs offer personalized portfolio management services but typically come with higher costs compared to pooled investment vehicles like mutual funds and ETFs. These accounts often have management fees that range from 0.50% to 1.50% annually, depending on the asset class and account size. Additionally, SMAs may incur custodial fees, administrative charges, and performance-based fees, further impacting the overall cost.

3. Aggregate Cost Considerations

All-In Costs:
Combining advisory fees and product costs provides a comprehensive view of the total expenses borne by investors. While advisory fees have remained stable or increased, the decline in product costs has contributed to a reduction in the overall cost of investment management. For instance, if an advisor

charges a 1% AUM fee and the average expense ratio of the investment products used is 0.42%, the total annual cost would be approximately 1.42% of assets under management. However, clients utilizing SMAs may see higher aggregate costs due to the additional fees associated with personalized portfolio management.

Fee Compression:
Despite the reduction in product costs, there is limited evidence of fee compression in advisory services. Advisors continue to maintain their fee structures, often justifying them through the value-added services they provide, such as comprehensive financial planning and personalized advice.[1]

Conclusion

Over the past few decades, while investment product costs have declined significantly, advisory fees have remained stable or experienced modest increases. This dynamic results in a nuanced trend in the total cost of financial advisory relationships, with overall costs potentially decreasing due to lower product expenses, even as advisory fees persist at consistent levels.

References

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