

Are You Confused About Investment Costs?

Part 2: Custodian/Brokerage Costs

In our last piece, we covered fund management costs. Now, let's take a step back from the mutual funds, ETFs, or other holdings you decide to invest in. *Where do these holdings live—and what does it cost to buy, sell, and hold them?*

An Account of Your Accounts

First, let's define a few terms:

Investment Accounts: It's easy to see where your holdings live. They live in two main types of investment accounts:

- *Individual accounts*, which you set up and manage on your own (along with your financial advisor, if you have engaged one).
- *Employer retirement plan accounts*, such as 401(k) or 403(b) plans, which your employers set up and manage for you.

Custodians/brokers: There are two kinds of custodians where your individual and retirement plan accounts typically reside:

- *Traditional custodians*, like Schwab or Fidelity.
- *Online platforms or robo-advisors*, like Robinhood, Wealthfront Advisers, or Schwab Intelligent Portfolios.®

Your custodian uses brokers to actually execute your trades. Some custodians double-duty as the broker; others contract with third parties.

The Cost of Doing Business

It really doesn't matter which types of accounts you've got, which custodians or brokers you're using; or what your investments are. You're not the one trading in the market. You (or your advisor) place trading orders. Your account custodian executes the trades.

Until a few years ago, brokers would almost always charge a commission whenever they executed a trade for you. In a more recent "race to zero," many providers are now touting commission-free trading. But is that trading really free? If you take one thing from today's piece, here it is:

As an investor, whenever you're being led to believe you're getting something for nothing, your best bet is to assume exactly the opposite.

Custodians and brokers must be profitable, or they'd go out of business. If they're not charging a commission on your trades, they're still making money somehow. It's not where you'd expect to see it, nor can you tell how much it's really costing you.

Hidden Trading Costs

Unfortunately, hidden costs usually mean higher costs. Following are a few tricks of the trading trade that often replace or augment more transparent pricing.

Cash sweeps and lending practices: Ideally, you invest most of the money you've earmarked for investing. But you may also hold cash in your investment accounts. Some custodians have been profiting by quietly sweeping this cash into their in-house, low-rate bank accounts, instead of paying you market-rate interest. They can then reinvest your cash in higher-rate holdings, or lend it out and earn interest on it—and keep the difference for themselves. Add everyone's cash together, and the profits can pile up.

Payment for order flow: Your custodian arranges for your trades to be executed. In theory, they're required to seek "best execution" for your trades. In

practice, one common technique is to use payment for order flow to seek competitive trading bids from third parties. Sometimes, this can generate more competitive pricing that benefits you. But it also can create conflicting incentives if an entity offers your custodian more payment (for them), without also ensuring best execution (for you).

Platforms have been under scrutiny on this front, including a 2020 U.S. Securities and Exchange Commission (SEC) charge that Robinhood was misleading customers about the true costs of their trades. Neither admitting to nor denying the charge, Robinhood paid a \$65 million fine and agreed to review their payment for order flow and other best execution policies and procedures.

Bond markups/markdowns: If you're trading in individual bonds, there are usually significant hidden costs known as markups and markdowns. When bonds are bought and sold, there is the equivalent of a "wholesale" versus "retail" price. The markup/markdown is the difference you pay above the "wholesale" price. This undisclosed difference typically goes to the broker, in addition to any disclosed commissions paid.

How financial advisors help: We advise you on managing your wealth across your total investment portfolio, wherever your accounts may reside. Do your investments best reflect your personal financial goals and risk tolerances? How can you spend safely in retirement, and which accounts should you spend down first? What about Social Security? Are your estate plans up to date, with accurate beneficiaries across your various accounts and policies? How can you effectively draw personal wealth out of your business? How can you integrate your charitable giving with optimal tax planning? Helping families illuminate and eliminate excessive investment costs is one way we strive to add value.

Until next time, no regrets!



Eric Hutchens
President & Chief Investment Officer

Allodium In the News



Sgt. Brieanna Olson

Minnesota Army National Guard Sgt. Brieanna Olson presented Employer Support of the Guard and Reserve (ESGR) Patriot Awards to Allodium's David Bromelkamp, Eric Hutchens, and Tyler Chapman.

Brie has been a Minnesota Army National Guard member for seven years and has reenlisted for another six years. She is qualified as an Information Technology Specialist and Multichannel Transmission Systems Operator-Maintainer. At Allodium, Brie has been working as an Operations & Technology Associate for two years.

David Bromelkamp appreciates what Brie does for the Allodium team and the country. He has signed an Employer Support of the Guard and Reserve Statement



of Support, pledging support of the country's service members and their families in peace, in crisis, and in war. To learn more about this award and the National Guard: <https://tinyurl.com/mry8ajh8>

Headlines

- Allodium was excited to host author Samuel Adams as a featured speaker with Dave Bromelkamp and Derek Van Calligan. They presented *Navigating the Sustainable Investing Landscape with Author Samuel C. Adams* on January 26, 2023. In case you missed it, the presentation is on our website and YouTube channel.
- Join us in congratulating the following team members for promotions!
 - Eric Hutchens, President & Chief Investment Officer,
 - Derek Van Calligan, Investment Consultant & Director of Investment Research,
 - Naomi Rogness, Client Service & Financial Planning Associate,
 - Renae Mottaz, Senior Client Service Associate
- Allodium welcomed three new clients in the fourth quarter of 2022.
- Our office will be closed April 7 and May 29 for company holidays.

To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

FINANCIAL PLANNING TIP

How Can We Help You Today?

At Allodium we are here for you, our clients, to help you determine the best course of action for yourself and your family. We welcome your questions on all financial topics. Over the past year we have helped clients to:

- Obtain financing for a bridge loan to buy a house.
- Settle an estate.
- Find a corporate trustee for an ILIT.
- Switch from one corporate trustee to another for lower costs and better service.
- Update an estate plan.
- Submit a COLA form for spousal maintenance.
- Change bank accounts.
- Give to charity.
- Set up retirement plan for self-employed person.
- Determine best benefits to choose at the workplace.
- Sign up for Social Security and Medicare.
- Update beneficiaries.
- Switch to a lower cost life insurance policy.
- Change insurance agents for better service.
- Open a high yield savings account.
- Find a better credit card.
- Buy I Bonds.
- Select a new CPA or attorney.
- Examine and reduce lifestyle expenses.
- Decide which is better — to rent or to buy?

These are just some of the things we can do for you, in addition to our ongoing investment management, tax planning and financial planning services. Think of us as your "personal CFO."

We are only a phone call or email away when you have a question or need help with a financial matter. We are also happy to help your family members when they have questions. We appreciate you as our clients and strive to provide the best service to meet your needs.



Steward is published quarterly by Allodium Investment Consultants. Please contact iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.



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