

# SmartMoney

AUGUST 2004 | WWW.SMARTMONEY.COM

THE WALL STREET JOURNAL MAGAZINE OF PERSONAL FINANCE

SPECIAL ARTICLE  
REPRINT FEATURING  
**OptionsXpress**  
**Ranked #1**  
among Discount  
Brokerage Firms

After countless clicks, calls and trades, we've ranked 24 brokerages according to everything from stock picking to customer service. Perhaps more important, we'll help you figure out which broker is right for you.

## The Perfect Fit

Louis and Karen Constan were feeling jittery about their portfolio. They've been managing \$900,000 of their retirement savings themselves using E\*Trade, a broker that has long catered to independent investors. "We got a little nervous," says Louis, a 57-year-old Saginaw, Mich., doctor. "The market's a little rough, and we were trying to do our own balancing, but it wasn't good." Then he mentioned his situation to a customer-service rep at E\*Trade last spring, and the firm offered him a portfolio evaluation—for free. ■ Financial advice from E\*Trade? Isn't that like taking cooking lessons from Ronald McDonald? The Constans decided to give it a shot. They completed a long questionnaire about their goals and their

**BY ANNE KADET AND RICHARD TEN WOLDE**

With reporting by Nicole Bullock, Chris Horymski, William Mauldin and Noah Rothbaum

*Reprinted and excerpted from the August 2004 issue of SmartMoney. Options Xpress had no influence on the editorial content of this article. SmartMoney does not endorse any product or service of Options Xpress.*

holdings at both E\*Trade and their full-service broker, Smith Barney. Then, in a series of conference calls, an E\*Trade adviser helped the Constans iron out a longstanding disagreement over risk tolerance. “She did a real counseling job and led us to a consensus,” Louis says. In the end, they sold some risky stocks, transferred the money into a few carefully chosen funds and bonds, and walked away with a blueprint for maintaining an appropriate asset allocation. While noting that E\*Trade makes a commission on the trades, “it wasn’t a hard sell at all,” says Louis. “It was, ‘What can we do to help you?’ This may sound strange, but it was the best overall review I’ve ever had.”

A year ago you couldn’t get advice from E\*Trade, period. Trades at the firm used to cost \$19.99. Now, if you invest at least \$50,000, you pay \$12.99—and get access to a dedicated service hotline. If you invest in mutual funds, E\*Trade will rebate 50 percent of the 12b-1 fees no matter what your asset level. Then there are the 50 free trades you get just for opening an account. In short, E\*Trade is a much better deal than it was a year ago.

You could say the same about a lot of the firms in our tenth annual survey of discount and full-service brokers. In years past, we’ve reported that brokerages were raising fees on small-fry investors in an effort to extract a profit from people who don’t have much money and don’t trade often. This year they’ve glommed on to a more appealing tactic: trying to lure more-lucrative clients with better deals.

There are two reasons this is happening. First, the brokers have the money. Trading is up 70 percent year over year at some of the largest firms, and securities industry profits doubled from 2002 to 2003, to \$24 billion. Clearly, they don’t have to be as stingy as in years past. Second, as the industry’s consolidation continues and more firms focus on wealthier clients, the competition is heating up. It’s almost embarrassing what firms are doing to keep their best customers and attract new ones.

On the discount side, brokers are rolling out new features such as advanced options trading and record-keeping tools even as they slash commissions, offer free advice and hand out trades like candy. Harrisdirect, for example, offers 20 free trades and a \$100 credit. Vanguard and TD Waterhouse lure higher-asset investors with free portfolio consultations. This spring Ameritrade was giving away \$400 PalmOne PDAs; now the enticement is 25 free trades. Charles Schwab cut commissions by a third, to \$19.99, and baited the offer with the promise of free golf at the country’s finest courses—if you’ll just please, please, please transfer \$100,000 into a new Schwab account.

On the full-service side, Merrill Lynch is prodding brokers to improve their hand-holding skills *and* their ability to grab new clients. Last year Merrill introduced software designed to ensure

The clever, thoughtful touches at OptionsXpress impressed us. You can download a preprinted shipping label that allows you to FedEx your application for free. When you trade, you choose whether to pull the trigger or preview your order first.



OVERALL RANK	BROKERAGE/MINIMUM TO OPEN ACCOUNT	COMMENTS
1	<b>OPTIONSXPRESS</b> www.optionsxpress.com No minimum	Nearly flawless.
2	<b>MURIEL SIEBERT</b> www.msiebert.com No minimum	Great research and data.
3	<b>TD WATERHOUSE</b> www.tdwaterhouse.com \$1,000	Broad product and service offering: can meet any need.
4	<b>AMERITRADE</b> www.ameritrade.com \$2,000	Reliable, fairly priced; features for both newbies and sophisticates.
5	<b>HARRISDIRECT</b> www.harrisdirect.com No minimum	Best customer service in discount category.
6	<b>FIRSTRADE</b> www.firsttrade.com No minimum	Cheap trades, and that's about it.
7	<b>SCOTTRADE</b> www.scottrade.com \$500	Lots of branches; a good choice for beginners.
8	<b>WALL STREET ACCESS</b> www.wsaccess.com \$10,000	Caters to options investors.
9	<b>BROWNCO</b> www.brownco.com \$15,000	Geared toward the frequent trader.
10	<b>WALLSTREET*E</b> www.wallstreete.com \$2,500	Flaky at best.

\*For online market orders. \*\*Higher for limit orders.

that clients get more-thorough and standardized service. Brokers are required to build investment models based on clients’ individual time horizons, goals, risk tolerance and tax situation. UBS and Smith Barney have unveiled similar services and added a slew of new products, ranging from more mutual funds to mortgages and, thanks to Eliot Spitzer, outside research. UBS hosts conference calls between company strategists and prospective clients, covering topics from the benefits of muni bonds to how to handle the alternative minimum tax. Best of all, over the past several years, full-service brokers have been lowering the minimum threshold to tap into higher service levels.

And yet TowerGroup, a research firm, estimates 20 percent of clients leave their broker every year. Clients’ satisfaction with their broker has fallen by 28 percent since the bubble burst, according to market researchers at Spectrem Group.

That’s where our survey comes in. Over three months we grilled 24 brokerage firms with hundreds of questions about their prices, research, products and services. We examined their 1099s and account statements, test-drove their Web sites, pestered their customer-service reps, analyzed their stock picks and ranked their adviser qualifications. We opened 18 accounts and made 90 trades. As a result, we have the information you need to choose

## Discount Brokers

STANDARD COMMISSION*	REDUCED COMMISSION	ANNUAL ACCOUNT FEE (HOW TO AVOID)	AVERAGE PHONE HOLD TIME (MIN:SEC)	SCORES					
				COMMISSIONS AND FEES	CUSTOMER SERVICE	MUTUAL FUNDS	TRADING TOOLS	RESEARCH	BANKING AMENITIES
\$14.95	None	None	0:30	★★★★★	★★★★	★★★★	★★★★★	★★★★	★★★
14.95	Individually negotiated	None	0:51	★★★	★★★★	★★★★	★★★★	★★★★★	★★★★
17.95**	\$12 with 18 trades per quarter OR \$250,000 in assets	\$100 (\$35,000 in assets OR 2 trades per 6 months)	1:27	★★★	★★★	★★★	★★★★	★★★★	★★★★
10.99	None	\$50 (\$2,000 in assets OR 4 trades per 6 months)	0:50	★★★★	★★★	★★★	★★★★	★★★	★★★★
19.95	\$14.95 with 18 trades per quarter	\$60 (\$10,000 in assets OR 3 trades per year OR \$2,500 margin balance)	0:36	★	★★★★★	★★★	★★★★	★★★★★	★★★★
6.95**	None	\$35 (1 trade per year)	0:24	★★★★★	★★★	★★★	★★★	★★★	★★★★
7.00**	None	None	0:34	★★★★	★★★	★★★	★★★	★★★★	★★★
19.95	Individually negotiated	None	0:13	★	★★★	★★★★★	★★★	★★★★	★★★
5.00**	\$4.50 when commissions exceed \$350 per month	None	1:16	★★★★	★★	★★★	★★★★	★★★★	★
14.00	\$9 with 30 trades per month	\$100 (\$10,000 in assets OR 1 trade per year)	0:53	★★★	★	★	★★★★	★	★★★★

a broker that fits your needs: See our data tables above. But a survey is no fun without anointing winners and losers, so we've got those, too. Read on for this year's results.

*[The following is excerpted]*

### Discount Brokers

The brokers in our “basic” category are true discount firms. Shirking the trendy advice business, they focus their efforts on providing the independent investor with an efficient, hassle-free trading experience—plus all the research and tools he needs to manage his own portfolio—at a rock-bottom price. Well, that's how it works in the best of all possible worlds. And this year's winner, Chicago-based **OptionsXpress**, has the goods. It beat the others by a nice margin.

Don't let the name spook you. You don't have to trade options to appreciate this brokerage (though the site's free mock options trading is a fun way to learn). While the brokerage started in 2001 as a narrowly focused equities and options firm, it has since expanded to offer all the products and services you'd find at a mainstream site—and does it better than anyone else. First, for infrequent traders, it's the cheapest broker overall. While \$14.95 trades are hardly the lowest in the survey, that same rate

applies across the board, whether you're placing a limit order, buying a fund or need a broker-assisted trade. Plus, rarity of all rarities, the brokerage doesn't charge fees. Period. Customer service is flawless if a bit brisk (the place is still small enough, with just 90,000 accounts, that you may get the harried president answering the phone), and the Web site is cleanly designed and easy to navigate. But it was the clever, thoughtful touches that impressed us most. When you register for an account online, you can download a preprinted shipping label that allows you to FedEx your check for free. When you trade, you choose whether to pull the trigger or preview your order first.

If there's one thing that makes **Muriel Siebert** stand out (beyond its status as a perennial runner-up in this survey), it's the overwhelming wealth of data, research and screening tools on the site. Siebert lets you analyze a stock more ways than Pfizer's got pills. We were impressed with the customer service as well. Phone and e-mail queries were handled with cheerful dispatch. And when we placed an online limit order for \$12 of an obscure bulletin board stock, a rep called to warn us that it was highly illiquid, then placed the order himself and waived the commission, which would have exceeded the cost of the stock.

**Ameritrade** is supposed to be targeting the \$100,000 to

## How We Do It

**To get the most out of** our broker survey, it's important to know the assumptions behind our rankings.

Since the rankings are based on 246 criteria, the process rewards firms that excel in all areas and punishes those that specialize in one or two. Full-service winner Merrill Lynch might not be your ideal brokerage if you have a \$90,000 portfolio and all you want to invest in is dividend-paying stocks. Edward Jones loses points because it doesn't offer stock options, and its conservative stock picking suffered in last year's speculative market. Another example: Vanguard was last in our premium-discount category, thanks to high commissions and mediocre customer service. But it would be a fine option for an IRA investor who wanted nothing more than to dollar-cost average his way into commission-free Vanguard index funds. If you're passionate about pinching pennies, look for the broker with five stars in the commissions and fees category.

Another caveat: We restricted each firm to only one level-of-service category (basic discount, premium discount or full service). We assigned the category according to where it does the bulk of its business. This decision doesn't sit well with Schwab, which would like to be included in all three categories. The firm has been expanding into the full-service arena for years and in February launched a discount-trading platform called Schwab Trader CT. Perhaps we'll revisit our

approach in future surveys, but for the time being, we had to put everyone somewhere. Our hands-on testing is based on the most basic account offering from each brokerage—the one that requires the smallest minimum asset size to open. Since many brokerages offer improved customer service to higher-asset customers, take into account that you may get better service. Our rankings do factor in the reduced fees and commissions charged to accounts with higher balances.

When it comes to judging customer service, we pull out all the stops. After opening a test account with each online firm, we become every brokerage's worst nightmare: a low-asset client who is a constant pest. We call each brokerage with questions at least five times, and send them just as many e-mail messages. We rate the quality of their replies and the time it takes them to respond. But we don't stop there. We also rate the account-opening process, taking points off for annoying snafus, and test each firm's Web site, rating how easy it is to navigate and how long it takes to find information. We score the trading mechanism to see how easy it is to make a trade and find relevant information—such as account balance—before and after the fact. Finally, we examine each brokerage's account statements and 1099s, giving higher marks to brokerages that make it easy for you to track your investments and fill out your tax return.

\$200,000 crowd these days, but it's hard to see the difference—it's still the mammoth, egalitarian and happily glitch-free operation it was last year. New to the mix is the online exchange-traded funds center, which provides lots of ETF-related education, news and even an ETF screener. We were impressed by the fact that e-mails were almost always returned within the hour.

Also worth a look is **Scottrade**. Never mind the clunky, outdated Web site—this is the best bet for beginners and small-time investors. With \$7 trades, zero maintenance fees and a \$500 account opening minimum, it's certainly affordable. Another attraction is the 200-plus branch network expanding across the country. When you open an account, you get contact information for the nearest one, and each time you phone, you'll reach the local manager or one of his assistants. They don't give advice, but they will happily answer dumb questions. "We want virtually everybody," says CEO Rodger Riney. It's no wonder this once-tiny broker has grown 50 percent, to 1.3 million accounts, since we surveyed it a year ago.

**BrownCo**, on the other hand, is a favorite among higher-asset investors and heavy traders. You need \$15,000 and five years' investing experience to open an account (not that anyone actually checks on the latter). Trades are just \$5, and frills are sparse. BrownCo seems to take pride in its minimalist approach: After

noting on our questionnaire that it offered almost nothing in the way of banking amenities, the firm added, "Most of the above services are not desired by our unique and investment-savvy clients." Well, our unique and savvy side liked the efficient trading page that displayed our available cash balance, and there's lots of research, including J.P. Morgan analyst reports.

And then there was **WallStreet\*E**, a firm we last reviewed in 2001, when we heard the sounds of hammering and sawing every time we called customer service. The racket has since diminished, but the weirdness rages on. Misspellings and grammatical errors all over the account application were the first clues that something was off. The data and research sections consist in part of links to other Web sites. One morning we were surprised to find that the Web site had totally disappeared, only to return the next day. We thought it odd that the site seemed designed to serve stockbrokers rather than retail investors. We later learned that our account had been miscoded to log us into the institutional side of the site rather than the retail side. CEO Carlos Otalvaro says the account application was designed by the tech department ("They're more focused on making things work than on the customer experience") and has since been corrected. He referred to the miscoding on our account as "a simple clerical error." As for the MIA Web site: "I don't know what you're talking about!" 