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TRADING

The Best Online Broker

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A relatively new player sweeps our rankings.

Bear markets aren't all bad. Consider one byproduct of the 2000-02 meltdown. As their portfolios shriveled, many investors hunkered down and stopped trading. That sparked an old-fashioned price war among online brokers, and commissions tumbled. Sparse trading also spurred industry consolidation. Gone are such discounters as BrownCo, Datek, Harrisdirect and Waterhouse. The survivors are providing customers with more services than when we last surveyed the group, in October 2004.

For this in-depth look at online brokers, [we examined 11 firms](#), including the remaining major players as well as several small shops you may not have heard of. We looked at their prices and offerings for two kinds of people: those with more than \$50,000 to invest and those with more than \$500,000 to invest. The winner, in both categories, is a relatively new firm, OptionsXpress. Muriel Siebert & Co. comes in second, also in both categories. Wells Fargo finishes third.

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Only when you get to fourth place does account size make a difference. Low-cost Firstrade finishes fourth for \$50,000 accounts, while Charles Schwab & Co. takes fourth for \$500,000 accounts. Schwab, which invented the discount-brokerage industry, is an odd duck. Every year it seems to look more and more like a full-service broker, albeit a low-cost one.

OptionsXpress has a lot going for it. You'll like its fast service, wide fund selection and low fund prices. "Online investing is a whole different language, and OptionsXpress helps you get started," says Hunter Bradford, 28, regional sales director in Chicago for a medical-software company based in Wyoming. "It's very simple and easy to use." On the other hand, OptionsXpress doesn't boast the cheapest stock commissions, and it doesn't offer any no-transaction-fee funds.



The fact is, what's best for you often depends on the kind of investor you are. If you crave research, the best choice by far is Fidelity, although it ranks fifth overall for both \$50,000 and \$500,000 investors. Investors looking solely for the lowest prices to trade stocks and funds should consider Wells



Hunter Bradford likes OptionsXpress, the number-one discount broker in our rankings, because it is easy to use.
Photo by Anna Knott

Fargo. If you open a Portfolio Management Account (the firm's high-end checking account) with as little as \$100, and you keep at least \$250,000 in your brokerage account, you get your first 50 stock or fund trades free each year. Bear in mind, though, that commissions outside the PMA program are \$19.95.

What they charge

Buying and selling stocks on the cheap was discounters' prime reason for being from the start. For trades of 1,000 shares or fewer, newcomer TradeKing (\$4.95) and Firsttrade (\$6.95), along with Scottrade (\$7), rank best in this category. But overall, commissions cluster tightly. Other than surprisingly expensive Vanguard (\$25 in a \$50,000 account), OptionsXpress and Siebert tie for the highest stock commission, at just \$14.95 per trade. It's also heartening to see that higher commissions for limit orders have vanished completely. Note that Schwab's stock commissions drop to a competitive \$9.95 (and Fidelity's to \$8) if you and others in your household invest \$1 million combined.

Commissions, however, aren't the whole story. Many brokers hit you with pesky fees. So we added up the charges for such things as inactive accounts, annual IRA fees, and even fees to close an account. Schwab wins the "award" for high incidental fees. For instance, it charges \$95 to close your account, \$2.50 to send you an old statement and \$50 to obtain a stock certificate directly from Schwab. E*Trade Securities is second worst in this department. Vanguard, OptionsXpress and Siebert are best at minimizing nickel-and-dime charges. For \$500,000-plus customers, TD Ameritrade and Fidelity Brokerage also hold down fees.

When you buy or sell a stock, several hands touch your order, each pocketing a small amount. Here again the news is good: Thanks to heightened regulatory scrutiny, the brokers themselves are now earning an insignificant amount for executing stock trades. None nets more than a penny or two on any trade -- and even that level of compensation is extremely rare.

We looked at how well each broker spreads its trades among a variety of market participants -- an indicator of how well the broker's computers are shopping your trade around for the best possible price. Vanguard places highest in this category, followed by TD Ameritrade and TradeKing. At the bottom, from best to worst, are Scottrade, Schwab and Firsttrade.

We penalized firms that route a large percentage of orders to firms they own. Here Fidelity, E*Trade and Schwab are the three worst offenders. Although Schwab sold its market maker two years ago, it agreed as part of the sales contract to continue sending orders to its former subsidiary for eight years. Brokerages that route orders to firms they hold only partial ownership in were also penalized, but less severely.

Is anybody home?

Bad service is unacceptable. You should not have to experience long waits when you need to talk with your broker. We set up accounts at all the brokerages, then tested how quickly we could get a broker on the phone, dialing each firm three times during a relatively quiet trading day in April. Siebert brokers answered our phone calls in an average of 21 seconds. OptionsXpress took 24 seconds; Firsttrade, 30 seconds; and TradeKing, 42 seconds. The slugs: E*Trade took 10 minutes; Schwab, 4 minutes and 26 seconds; and TD Ameritrade, 3 minutes and 32 seconds.

To prompt a rapid reply, we next sent a panicky e-mail to each broker, falsely accusing it of misplacing a

\$25,000 check. TradeKing took 17 minutes to answer our question. (Automatically generated computer responses didn't count here.) Siebert answered in 44 minutes. Next best was TD Ameritrade, which replied in 13 hours and 24 minutes. The out-to-lunch (and dinner and breakfast) bunch: Scottrade didn't reply for 28 hours and 47 minutes, E*Trade for 22 hours and 8 minutes, and Schwab for 21 hours and 43 minutes.

Instant messaging works much better. Brokers that have it -- OptionsXpress, Fidelity and TradeKing -- all responded in 90 seconds or less. We gave all three extra credit for offering this handy option.

Finally, we quizzed the brokers to determine how well they could answer customer questions. We asked each broker the same three questions over the phone. Schwab brokers performed best in this exercise. TD Ameritrade and OptionsXpress tied for second; Fidelity finished last.

Best for funds

A good reason to open an online account is to consolidate your fund investments. An online brokerage makes it much easier and faster to sell one fund and buy another from a different family, cuts down on mailbox clutter and should make reporting your annual gains and losses to the IRS a snap.

We ranked brokerages on how many no-load funds they offer, how many of those no-loads are available without a transaction fee and what you pay for funds that *do* have a fee. We placed the greatest weight on the last question because many first-rate, low-cost funds are available only for a fee.

Schwab, which pioneered the fund supermarket concept, offers almost 4,000 no-fee funds -- more than twice the number offered by the second-place finisher (Firstrade, with 1,917). But woe to you if you pick funds not on the no-fee list. Schwab transaction fees run from \$49.95 to (gulp) \$164.95. Moreover, you pay not only when you buy, but also when you sell. TD Ameritrade isn't much better, charging a flat \$49.99 to buy or sell.

The clear winner in this category is Firstrade. It doesn't charge a thing to buy or sell any of its no-load funds. OptionsXpress and TradeKing tie for second, charging \$14.95 each way, though neither offers no-fee funds.

As for the total number of no-load funds available, OptionsXpress and Schwab each boast about 5,400. TD Ameritrade and Siebert each offer about 4,000. E*Trade, Scottrade and TradeKing bring up the rear in this category, each offering fewer than 1,900 no-load funds. Before opening an account, check to make sure that the brokerage offers the funds you want.

A broker should allow you to make quick work of Schedule D at tax time. Our test: The brokerage should mail you a free statement showing the average cost basis of each fund or stock you sold the previous year. (We gave half credit for those that make you print the statement from the Web site.) Even so, TradeKing flunks because it provides no free tax-basis information. TD Ameritrade fails for \$50,000 clients.

Great for cash

Cash is no longer trash. The average yield of taxable money-market funds now stands at 4.2%. You should be earning close to that on money in your brokerage account that isn't otherwise invested. But many brokers either pay indecently low yields on cash or make you negotiate a maze to earn market rates. E*Trade and TD Ameritrade take the prize for stinginess. Cash balances under \$5,000 earn just 0.2% annually at E*Trade, and TD Ameritrade pays zip on cash balances of less than \$2,000. On higher TD Ameritrade cash balances, you may choose a money fund, which recently paid 3.7%. But if you fail to ask for that fund, you earn 0.4% or less on balances of less than \$25,000. Schwab has an equally complex and nearly as penurious system. If your total

account is worth less than \$100,000, you earn 1% on cash; if your account totals less than \$500,000, the most you'll earn on cash is 2.2%.

An online brokerage should sweep your money into a money-market fund automatically -- and some do. A money fund offered by Vanguard recently paid 4.4% on cash balances; one from Wells Fargo paid 4%; one from Siebert, 3.7%; and one from TradeKing, 3.6%.

Interest rates vary less for investors who use margin -- that is, borrow money against the value of an account. We averaged the rates brokers charge on \$25,000 and \$50,000 loans. Siebert (7%), TradeKing (7.3%) and OptionsXpress (7.4%) were best; TD Ameritrade (9.5%), Scottrade (9.1%) and Fidelity (9.1%) ranked worst.

Web-site winners

We also looked for the features that most investors want in a broker's Web site. When you're about to place a trade, how many mouse clicks does it take to get a real-time quote? To determine your cash balance? To find out whether a fund carries a fee? To locate copies of old statements online?

We ranked the Web sites using ten criteria. Fidelity and E*Trade require the fewest clicks, and Schwab ranks close behind. Siebert's Web site is the pits, and Firstrate's and TD Ameritrade's aren't much better.

Research champs

Three of the online brokers offer a full complement of stock research. Fidelity is tops. It gives you extensive research from Lehman Brothers and Prudential Equity, plus reports from numerous smaller, independent firms. Altogether, you get as much research from Fidelity as you do from most full-service brokers.

Schwab, which ranks second in this category, emphasizes its own research. Its computer-generated Schwab Equity Ratings have performed well so far. Clients with \$100,000 or more also get Goldman Sachs research. Like Fidelity, Siebert offers Prudential reports and Lehman highlights, along with a fistful of boutique research, most of it quantitative.

Is free, first-class research a high priority? Almost all of the brokers offer Standard & Poor's stock reports as well as reports from a handful of other firms. But none comes close to matching Fidelity, Schwab or Siebert in terms of quality and breadth. Of the rest, E*Trade, which offers Credit Suisse research to clients with \$100,000, is best, and TradeKing, which only began operating in December 2005, ranks last.

Who stays clean

Squabbles with regulators and customers are minuses. We totaled the fines levied against each broker over the past three years by regulators, the courts and the stock exchanges. To that number, we added the money awarded to customers in arbitration proceedings. We divided that sum by the average number of trades at each firm to avoid penalizing the larger brokers.

Wells Fargo finishes last, but the score requires a caveat. Wells's full-service brokerage dwarfs its online brokerage, and full-service brokers tend to have more run-ins with clients and regulators. We divided Wells's penalties by the average daily trades of the discount and full-service units, but the firm still had the worst conduct ranking. TD Ameritrade finishes second worst.

The top clean-hands firm is Firstrate, followed by OptionsXpress, E*Trade and Scottrade. TradeKing is too new to rank. Vanguard, Schwab, Siebert and Fidelity were in the middle.

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