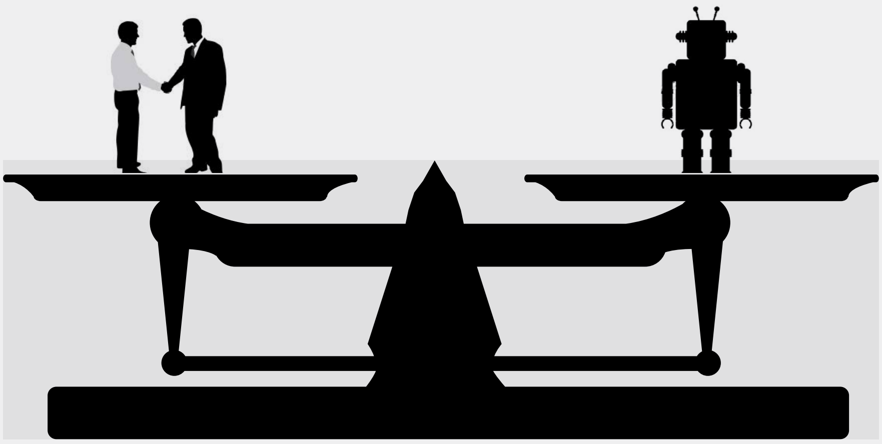
THE VALUE OF ADVICE



In an age of automated investing and self-management, just how can we measure the true value of advice? Justin Hooper counts the ways.

THERE'S A LOT OF discussion about financial advice and many clients are deserting their advisers due to a perceived or actual lack of value. Yet there is no doubt that high quality financial advice can literally be life changing.

The intention of this article is to provide the reader with a clear idea of how much value a high quality adviser can provide and in doing so hopefully provide the reader with not only a clearer method of seeking such advice but also a way of evaluating the cost and benefits.

Financial advice has both tangible and intangible benefits even though much of the intangible value is 'in the eye of the beholder'.

TANGIBLE VALUE:

IMMEDIATE DOLLAR IMPACT

It is often possible for an adviser to literally save their client hundreds or thousands of dollars and for SentinelWealth it is not uncommon for the direct savings to exceed 50% of the fees charged.

Some methods in which this occurs includes:

Reduced costs of administration and investing – the average administration fees charged to investors is approximately 0.6% of the funds invested or $3000 for every $500,000. This cost could be as low as 0.3% creating a saving in the order of $1500 for every $500,000 and more on larger portfolios. Retail investment fees are around 1% p.a. with few funds charging less and many charging a lot more. By accessing funds and investment alternatives on a wholesale basis, it not only reduces the cost (often by more than 0.5% p.a.) but also expands the range of options. Many investment options are not available to retail investors.

DIY investors are often the victims of brokerage fees as high as 1%. On the implementation of a portfolio of $200,000 a fee over $2000 is not uncommon even though it could be half this.

Improved returns – research from Dalbar Inc shows that the average investor underperforms the markets by 4% per year on average. The average client of financial planners has an improved performance (90%) and index tracking investors are likely to beat at least two thirds of all investors in any one year and about 90% over any two years. An improved return of only 1% per year has a significant impact over the long-term

Tax savings – the identification of expenses to be brought forward or income deferred (in conjunction with the accountant). This could be through simple methods such as the transfer of an investment into superannuation, making additional contributions or even triggering the pension rollover or a transition to retirement strategy.

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Reduced Insurance premiums – a reduction of up to 30% can easily be achieved simply by eliminating any commissions charged on the policy. Although the adviser may charge a fee to provide advice and implement the policy, the saving in premium is permanent and has a big impact on annual cash flow.

Additional Social security – clients are often eligible to receive benefits not currently being received.

Interest and costs on debt – most clients don't check the alternative providers and are not sufficiently aware of the flexibility available. For example, a commission of 0.5% is usually payable on the establishment of a loan. In many cases, either all or most of this can be avoided.

In addition, other loan costs and interest rates available from alternative providers should result in an overall saving in the order of 0.5% p.a. or $2,500 on a $500,000 loan.

Reduction in Professional fees – it is usually the case that solicitors, accountants or other professional advisers are required for specialised areas such as estate planning. In these cases, a good financial adviser would not only brief the other professional and provide a set of concise information but also negotiate fees on behalf of the client. In our case, on many occasions this combination results in savings to the client of over $1000.

TANGIBLE VALUE:

OPTIMISING STRATEGIES

Financial strategies usually have a medium to long term impact and the financial impact may be significant. For example:

Estate planning – many strategies can add significant value to the assets of a family. For example, where a couple have children who are no longer financially dependent, it is possible (and very common) that significant and unnecessary tax will be payable on their superannuation assets once both of them die. This is avoidable.

Inappropriate drafting of a will may result in the squandering of assets through either a beneficiary not being adequately equipped to deal with the situation in which they find themselves, or a challenge to the will being lodged resulting in significant costs and a possible breakdown of the family relationships.

Superannuation – a significant number of opportunities within the framework of superannuation legislation exist. Some of the more obvious include what contributions to make and when, what fund to use, whether a self-managed fund, public offer fund or industry fund, the possible impacts on members and when to trigger changes.

Investment Rules – otherwise known as an Investment Policy Statement, all investors should have a set of rules by which they manage their portfolios. These rules will specify exactly how the investment decisions will be made and more specifically how the potential impact of emotional decisions will be avoided.

Asset allocation – over 90% of investment performance is derived from the asset allocation within a portfolio. The ratios of investment to lifestyle assets, super to non-super, investment to speculative assets, defensive to growth (riskier) assets are all critical in particular to the risk being incorporated into the portfolio. Then at a more detailed level, the allocations to asset classes and sub-classes. For example, what proportion should be in shares, property, bonds, cash or commodities? To what extent are the risk factors incorporated or has the portfolio taken on risk without any probability of reward?

Manager selection and benchmarking – in both the USA and Australia there are more managers of securities than securities themselves. With well over 100,000 alternative investments, and a large number failing every year, it becomes a complicated and confusing issue. Quality advice not only provides a logical approach to narrowing down the options, but also provides detailed and rigorous research to provide the highest probability of delivering the desired outcome.

Once a selection has been made, monitoring and supervision becomes essential. Few clients managing their own portfolios create mandates or benchmarks for the portfolio managers making it impossible to measure their performance. With no objective measurement, there can be no effective management.

Leverage and debt management – almost every major catastrophe relating to an individual's personal assets or investments has been the result of either or both of excessive leverage or excessive concentration. At the same time, over 75% of the world's affluent people acquired their wealth from business assets (i.e. private equity in a professional practice or business) which usually required one or both of these 'risky' strategies. Knowing when these risks are worth taking and when not seems to be a difficult issue for many people who are too close to the issue to be objective.

FEW CLIENTS MANAGING THEIR OWN PORTFOLIOS CREATE MANDATES OR BENCHMARKS FOR THE PORTFOLIO MANAGERS MAKING IT IMPOSSIBLE TO MEASURE THEIR PERFORMANCE.

Budgeting and target-setting – by writing down goals the probability of achieving them is increased by over 80%. Although obvious and simple, setting and agreeing a future plan with targets and benchmarks remains a significant area of impact for clients. Targets should include earning and spending, net worth, superannuation and debt. At the same time, by allocating responsibilities and roles we are able to reduce confusion which is often the cause of procrastination in a busy world.

Getting stuff done – busy lives result in a lack of execution even when one knows what to do. Getting things done on a timely basis is not only satisfying but is often financially rewarding.

Getting organised – there are often very high costs incurred when one is not well organised. Can't find the relevant documentation when needed, not knowing what investments exist or not processing distributions from investments, not keeping employment records and many other ways people find to cause themselves significant cost can all be avoided by being organised.

Accountability – most people would accept that making themselves and others accountable for delivering against agreed actions will result in a better outcome. Yet few exercise this level of control over their own financial affairs.

Explaining and understanding the trade-offs – there is seldom only one answer to a problem. Providing the full range of choices and evaluating the consequences of each provides the client with the knowledge that the most appropriate solution has been selected. This allows for the cost/benefit analysis to be done in each alternative as well as a clear evaluation of all costs thereby allowing for the early elimination or reduction of many. By following a process of scenario planning, there is very seldom a feeling of regret after decisions have been made.

Saving time – time is money and the less time required the more time for other things.

Monitoring and Supervision
After plans have been set up and implemented, they need to be monitored. No set of strategies can remain appropriate forever so someone has to track their progress against agreed benchmarks and make the necessary changes. The areas that most need to be monitored include:

Cash flow – making sure that both the projected long-term needs are likely to be met as well as the immediate short-term needs whilst at the same time making sure that unnecessary costs are being avoided.

Client circumstances – making sure that the continual changing circumstances in which clients find themselves are being accommodated in the financial strategies.

Legislative and regulatory changes – often an area of little immediate value to clients but both history and logic would suggest these have added value to clients overall in the quality of advice on average.

IT IS NOT UNCOMMON FOR THE DIRECT SAVINGS TO EXCEED 50% OF THE FEES CHARGED.

Asset allocation – checking whether the intended diversification impact is being realised and making the necessary changes.

Monitoring of world events and applying appropriate strategies to meet client specific requirements.

Fund or security manager monitoring and tracking including regular analysis of portfolio holdings, changes in personnel, costs and potential risk factors. This includes managers currently being used and others.

INTANGIBLE VALUE

Besides the tangible value of advice, many clients would see the intangible value as being of much greater importance. Some of the areas in which clients perceive there to be value include:

Preventing mistakes – investment returns are not always going to be good and it's natural to want to 'fix' the problem by doing something. Sometimes the best advice is to do nothing.

Structure and discipline – our clients like to know that the advice they are implementing has a logical and structured basis…it makes sense.

Trust and independence – dealing with an adviser who has no direct or indirect conflicts and who knows your personal circumstances in detail, creates a feeling of trust. There are seldom any situations in life where advice is sought and the adviser is as free of conflict as is possible.

No stone unturned – knowing that a process exists that together with the lack of bias, results in the knowledge that every possible solution has been contemplated.

Filtering information – there is a vast amount of information and it's becoming more and more vast at a faster and faster rate – "the industrial revolution of data". It is increasingly difficult to tell the difference between data and information and a key role of any adviser is to make sense of it in the context of client needs and desires.

Insights – driven by a desire to assist clients to use their financial resources to enable their lives, we often have insights which are both unexpected and very much appreciated.

Risk profiling – having an appropriate level of risk in the structure of your portfolio to both deliver the required return but without the discomfort of intolerable volatility provides a more comfortable and comforting experience. We use a very sophisticated profiling tool to assist in this process.

The number – we will calculate your 'number'. This is the total asset base you will need before you can give up your 'human capital'. By doing this we put a stake in the ground and set a clear target. In many cases, clients learn that they are in fact 'working for fun' even though before this, they thought it was still absolutely essential that they keep going.

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Sounding board – on a regular basis our clients call us to get a view on something. It could be an investment someone talked about, a strategy, something they heard on the news or even something to do with a career or business opportunity. Having us there and knowing we're on your side and don't have conflicts or vested interests is very comforting.

Awareness – awareness is often 90% of the solution. Being aware means not only the current reality, but also the patterns that created it and the alternatives to improve it.

Learning – improved knowledge of not only some of the technical areas of money but also the psychological and behavioural areas.

Earnest and sincere – having an adviser who takes your situation extremely seriously whilst at the same time caring enough to provide practical and timely advice. It matters to us personally that you have the life that you most desire and that we get it right. ●

SENTINEL WEALTH

ABOUT SENTINELWEALTH

SentinelWealth has taken a leadership role among financial services practices in terms of reducing conflict – by having its own license, not accepting commissions or buyer of last resort opportunities, not accepting subsidies and returning all gifts. Adviser remuneration is derived from salaries and bonuses, with almost all dependent on client retention. For details, please ask your SentinelWealth adviser.

OTHER ARTICLES IN THIS SERIES

At the time of printing, The SentinelWealth Thought Leadership Series included the following titles:

- The requirements of true independence
- The real cost of investing
- The value of advice
- The 7 key steps to getting value from your adviser
- Greed is only a symptom never the cause
- Making quality decisions on a more regular basis
- Building wealth on purpose
- Integrating your money with your life
- The 7 steps to choosing an adviser

See the SentinelWealth website at www.sentinelwealth.com.au for an up-to-date list of titles.