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THE ABC OF INVESTMENT FEES

By Renee Eagar, Certified Financial Planner®, Brenthurst Wealth, Claremont

As financial advisors to many sophisticated clients, we are often second-guessed by clients questioning the role advisors play in managing their portfolios. I accept this as part of the role as financial advisor, especially since hindsight is always 20/20, when it is easy to point out alternative options that could have been chosen.

At the end of the day, my role is to suggest financial planning options based on what I know about my clients' circumstances, their goals and risk profile. They not only appoint me for my knowledge and guidance, but also for direction on the right investment options, products and various planning tools which suit their needs and lifetime objectives.

It's easy enough to buy unit trusts and retirement annuities, or even stocks and ETFs directly, but does one necessarily understand whether that will help you attain your financial goals? And is there a clear understanding of the intricacies and risks involved in each investment option's profile, and more importantly, the allocation of the underlying investments?

As a Certified Financial Planner®, my training has equipped me with the necessary knowledge and tools to assist my clients make the most informed and beneficial decisions. I've also been trained to rely on the expertise of highly skilled managers and platform providers of the investment funds I utilise to serve my clients' best interests.

Their expertise lies in structuring funds and/or products that offer a mix of diversification, growth and defence so that investors' capital grows over the long term without placing it under unnecessary risk.

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I'm grateful for their consistent expertise and input because it makes it easier for me to present my clients with the best possible investment options in all aspects, namely investment, tax and estate planning.

That expertise does, however, come at a price… just like everything else in life.

Allow me to outline the relationship between financial advice, investment expertise and the associated fees. The fees in its totality is referred to as the total expense ratio (TER), which is shown as a percentage of the total portfolio under management.

The TER is made up of three main fee categories:

1. **Advisor fee**
2. **Fund management fee – paid to the investment fund manager who manages the unit trust, ETF, etc.**
3. **Platform fee – paid to the company supplying the product you invest in.**

1. ADVISOR FEE

This is the fee that you can expect to pay your financial advisor, which is calculated as a small percentage of a client's portfolio. This fee is usually negotiated upfront and is levied monthly from your investment. Every month the fee is calculated using the current value of your investment.

One is often reluctant to pay fees on your investments, however, in a relatable scenario, you might feel comfortable doing simple DIY repairs around your home, but would you tackle a major renovation yourself without sourcing the necessary skills and tools, just to save costs? Hopefully not, because you could cause more damage should something go wrong. The same applies to your financial circumstances.

The sensible option is to approach an expert, even if there is a price to pay. In the long run, you'll always be better off by making the right decision.

For instance, many South Africans are currently considering money market accounts due to the volatility in equity markets and the high-yield interest the current cycle is offering. A move into more defensive assets seems sensible enough when world markets are so volatile, until you consider the full picture.

At a time when inflation is well above 6%, the 7% - 8% return offered by money market funds is quickly diminished by taxes on interest, which could be as high as 30% – 40% for high-net-worth individuals. Therefore, the net return in this situation would be closer to 4% or 4.5%, which is clearly well below inflation, so in effect you are losing buying power rather quickly over time.

This is one of many examples of the value that advisors can add to your long-term financial planning, although we ultimately play a far more important role. **A few years back, research by US mutual fund giant Vanguard determined that advisors could add as much as 3% value to clients' returns over time.**

What might surprise you is the area in which the most value was added. According to the research, as much as half of the 3% value add comes from helping clients stay invested, even through the toughest times.

I'm sure I don't need to remind you that the best returns are made by remaining invested for the long term and that over a period of 20 years and up, equities always come up trumps. For this peace of mind, your advisor will charge you a fraction of the value of your portfolio. This fee, as well as the other fees which I will discuss next, are deducted from your investment account, so there is no impact on your pocket or cash flow.

2. INVESTMENT MANAGER FEE

This is usually the larger of the fees applied to your investment portfolio and is also calculated as a percentage of your investments. These fees can vary from 0.1% to more than 2% of the assets being managed. These fees are included in the daily prices of the investment funds, so for example, if a fund reports a performance of 8% then it will be net of the applicable fund manager fee.

The percentage levied depends on a few factors. A more conservative fund will charge a lower fee than an aggressive fund, and an actively managed fund has higher fees than a passive fund. A combination of both always works well.

In some cases, the manager might also charge a performance fee for producing returns higher than a set percentage, and specialist managers, such as those managing hedge funds, often charge higher fees than those managing traditional funds.

Are these fees justified? If your investments continue to show growth over the long term and the fund manager manages to outperform a realistic market benchmark, then yes, the fund manager should be rewarded for good performance.

3. PLATFORM FEE

The lowest of the investment fees you should expect is the product fee which is deducted from your investment every month. This fee can range from 0.1% to 0.5%, depending on the platform used to make and manage your investments.

In addition to giving you access to investment products, the platform also manages the administration such as the buying and selling of investments, as well as providing important reporting tools.

Without access to these products and administrative capabilities, you wouldn't be able to manage your investments from a legislative, monitoring/tracking or tax reporting point of view.

The bottom line is that these fees are unavoidable if you wish to give yourself the best chance of retiring comfortably. Yes, you can attempt to manage your own investments, but this is not advisable unless you have the skills and expertise to do so.

The good news is, fees are not always fixed and you might have some room for negotiation on certain of the fees. Bulking your investments on one platform instead of having them spread across various providers, for example, will bring down your platform fee. Paying lower fees will ultimately result in a higher retirement savings, so one needs to ask the right questions and make informed decisions.

One is often reluctant to pay fees on your investments, however, in a relatable scenario, you might feel comfortable doing simple DIY repairs around your home, but would you tackle a major renovation yourself without sourcing the necessary skills and tools, just to save costs? Hopefully not, because you could cause more damage should something go wrong.

ADVISOR PROFILE: RENEE EAGAR, CERTIFIED FINANCIAL PLANNER ®

RENEE is head of the Claremont office. She is a CERTIFIED FINANCIAL PLANNER® professional and a member of the Financial Planning Institute of South Africa.

Renee ranked as one of SA's top three financial advisors at the 2022 Intellidex Top Private Banks and Wealth Manager Awards.

Renee has been in the financial services industry since 1998 and has worked for institutions such as TMA and Investec Asset Management. She obtained her Higher Certificate in Financial Markets in 2004 and attained her CERTIFIED FINANCIAL PLANNER® designation in 2006.

Phone: +27 21 100 3901 | Cell: +27 83 233 9373 | **Email:** renee@brenthurstwealth.co.za

The professional financial advisor acts in the best interest of the investor and puts their time and efforts into managing your portfolio. They have extensive knowledge of the different types of funds and have a range investment strategies. Their expertise and functional abilities can be advantageous to your portfolio management.

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