

FINANCE



WHAT SHOULD THE TRUE COST OF YOUR FINANCIAL PLANNER BE?

BY RICHUS NEL, FINANCIAL ADVISOR, BRENTHURST WEALTH

Financial advisors are generally measured one dimensionally by clients, by comparing portfolio returns (exclusively to market returns). However, in a low return environment (low growth, low interest and low inflation) clients should also consider:

- a) Their market outperformance brought on by their advisor and asset managers during prior market cycles – e.g. an increased foreign exposure strategy since 2012, that benefitted client portfolios hugely from significant RAND depreciation;
- b) The value of other services offered by financial advisors in respect of cost savings, tax savings and preventing financial mistakes (risk cover, wills, estate planning etc.).

Measuring financial advice solely on investment performance is setting advisors up for failure. Advisors have no control over markets in the short-term and are dependent on investors understanding this during

times of low or no return. As financial pressures increase, the necessity of quality advice increases.

What do investors have control over?

Investors can choose to seek professional financial advice but does this actually “pay” or result in superior outcomes? According to International studies (Value of Advice Report 2012 – Investment Funds Institute of Canada, Vanguard Advisor’s Alpha June 2016, Dalbar’s 22nd Annual report 2016 - Quantitative Analysis Investment Behaviour) the picture looks as follows:

Advisor utility by investors in Canada is 5 out of every 6. In the USA, 80% of investors with mutual funds make use of financial advice; in Germany, 80% and in the Netherlands, 51%. The results found from these countries studied showed a significant increase in savings, personal wealth, less dependency on the government and better state finances. These respective countries were less dependent on any foreign reserves,

which resulted in significant interest/ cost savings for those governments.

- Financial advice benefits (according to the studies mentioned):
- Accumulating greater wealth through a committed savings plan;
 - Resulting in a more comfortable retirement;
 - Selecting tax and cost-effective investment solutions;
 - Maintaining a long-term investment strategy, avoiding emotional investing;
 - Guarding against poor financial decisions.

Studies show advisors focus on:
1. Behavioural coaching
Investors typically “buy high” and “sell low”. The average retention rate of US mutual equity funds is 3,46 years where equities are only suitable for long-term investment horizons (7-10 years). Until the end of December 2015, the S&P500 earned an annual return of 10,35%. In comparison, the average mutual fund equity investor only captured 3,66%

return. The short-term investors' focus resulted in a return gap of 6,69% per annum. In recent years this gap has closed from a +/-10% gap in 1998 to +/-3,5% in 2015. This can be attributed to better education, understanding investors' emotions and managing those emotions more effectively with the help of financial advisors.

2. Required risk assessment and asset allocation

Financial advisors ensure that investors take sufficient risk (more than investors would generally be comfortable with on their own). This additional risk (and accompanied return compensation) over the long-term, plays a critical role in superior investment return outcomes for clients.

3. Asset manager selection

As important as asset allocation is, selecting asset managers and entrusting them with investor capital is equally important. These managers selected must differentiate themselves as excellent over the long-term (good and bad times).

IFAs in RSA have done a great job in selecting excellent asset managers:

- 35% of all general equity funds (with a 5-year track record or longer) have beaten the ALSI over 5 years;
- 67% of all the assets placed by IFA in independent general equity funds, have beaten the ALSI over the past 5 years;
- 99% of all assets placed by IFA in the general equity sector have produced returns above the sector average.

4. Costs/taxes

Generally, advisors are cost and tax cognisant and will provide advice on cost-effective investment solutions to their clients. These savings enhance investor returns significantly over the long-term. Advisor firms are able to negotiate lower fees with platforms and asset managers to the significant benefit of investors over the long-term. Tax planning is receiving an increased focus (due to rising taxes) and demand priority to individualised, tax efficient investment solutions.



Richus Nel, financial advisor,
Brenthurst Wealth

TOP TIP OF THE DAY:

Do not chase
yesterday's winners...

5. Financial planning

Financial planning specifically refers to investment and retirement planning illustrating investors' financial wellness. It includes any financial consideration, plan, discussion or guidance that improves an investor's financial well-being.

6. Managing downside risk

Managing risk is a key focus in personal finance for advisors. Financial risk is any event that could derail your client's financial plan. This includes personal liability, short-term damages (theft /accident), death, loss of income, medical emergency and even debt or business debtors not paying. Currency/cash flow/liquidity risks are managed. Risk planning even includes timely management of death bequests and guardian nominations for fostered children, preventing huge unnecessary costs/ losses through court settlement.

7. Drawdown rates/withdrawal strategies

Financial instruments dropping in

value always come as a shock to investors, even if investors are aware of the volatile nature of markets. Drawdown considerations managed by advisors:

- managing drawing percentages and escalations;
- source of drawing (considering tax efficiency);
- portfolio construction to safely fund that drawing.

8. Education

Financial advisors are providing a vital educational function within the South African context. This guidance is "principle-based", focussing on risk and personal finance matters. This empowerment leaves investors in a much-improved financial position. The more educated an investor, the better their financial position and the business relationship with them is more sustainable.

Conclusion

The international studies researched conclude that the return benefits from using a financial advisor could be as much as 1,5%-3% per year.

Behavioural coaching is found to be as high as 1,5% per annum on its own. Advisors holding clients' hands taking on the right level of risk (considering return expectation), plays an undeniable role in achieving superior returns. The difference in e.g. long-term equity returns compared to bonds/cash returns is enormous. Avoiding general investment mistakes also adds up quickly to a superior financial position.

Over a lifetime, these added services by financial advisors result in a significantly higher level of investible assets and a better financial position by retirement. A Canadian report stated that, over 15 years, the improved result from financial advice could be as high as 2,73 times, compared to unadvised assets.

In South Africa, the improvement in personal wealth, attributed to financial planners is suggested to be as high as 2%-4% per annum. This begs the question: What is the true value of your financial advisor and what is a fair price for that advice?

SOURCES

- Coronation Investment Forum presentation 2017
- Vanguard Advisor's Alpha June 2016
- Value of Advice Report 2012 – Investment Funds Institute of Canada

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