The value of financial advice?

INTRODUCTION – THE CHALLENGE OF VALUE VS FEES

In recent years, regulatory changes in the Australian financial advice industry have put the spotlight on fees. The package of changes that the government introduced to the Future of Financial Advice (FOFA) aimed to improve the industry's integrity while offering affordable and accessible financial advice to the Australian community.

However, we have also seen increased compliance, administration and documentation required to provide financial advice to an end investor. While this improves the risk management culture around providing advice, it has also added cost to the advice process. Unfortunately, not all clients understand or value much of the behind the scenes work that goes into preparing, delivering and implementing advice.

Over the last few years, given the strong global stock market performance and low interest rates, it hasn't appeared to be too difficult to put together a winning investment portfolio. This has led to scepticism amongst clients around paying their adviser to construct investment portfolios. However, the market sell-off in February 2018 and the return to a higher volatility environment accompanied by rising interest rates is a timely reminder that investors may need assistance to achieve their desired rates of returns, at the risk levels they can live with over increasing longevity horizons.

The industry's focus on portfolio returns, while important, overlooks the fact that standard investment selection is just one part of an adviser's value. Advisers have at times struggled to clearly articulate the benefit to their client of these additional services and specifically to attribute a dollar value to that benefit. However, in order to build long term trust with your clients, it is important to not only have transparent fee conversations but to also demonstrate the value that your advice is delivering. "Price is what you pay. Value is what you get." Warren Buffet

As background, Russell Investments has been producing the value of advice report in the US since 2013. Over the past 20 years, we've worked with top advisers around the world including the US, Canada, UK, and Australia The study is based on our 20 years of experience coaching advisers to make their practices more sustainable and to help build deeper relationships with their clients. Over time the study has evolved to reflect the changes in the industry, new competitive forces such as robo-advice and the capital market environment.

We make reference to the study in this report and discuss some of the key assumptions it makes. For example:

› The high cost of investor behavior. Over the past 34 years ending December 2017, a true adviser who is a behavioral coach, saving investors and other advisers from the emotions of investing, has the potential to add additional value to an overall portfolios return.

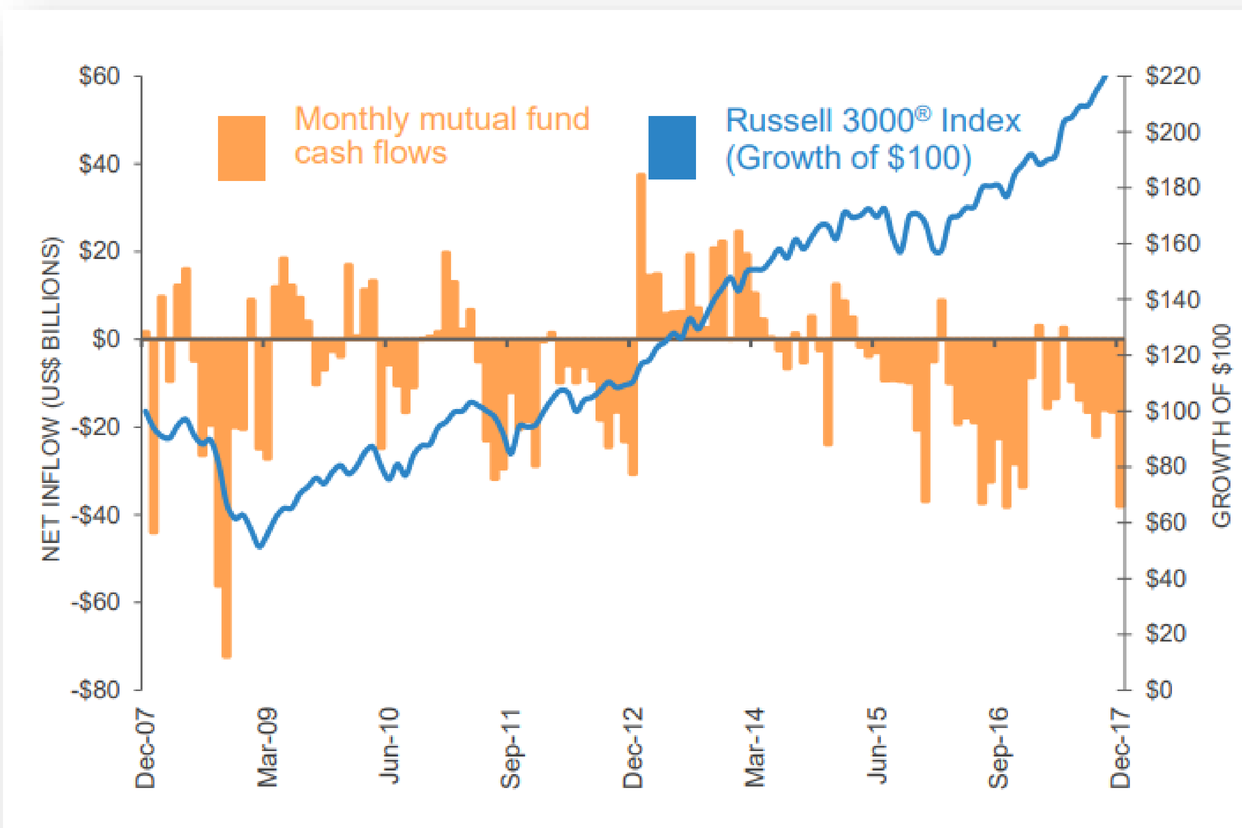
› The value in providing a more tax aware approach. Looking at the gap between the average annual return lost to a tax-payer vs the potential adviser tax-managed return.

1. Avoiding Behavioural mistakes can potentially add more than 1.8%p.a.

While “behaviour coach” isn’t part of the adviser job description, it is a significant contributor to total value. Left to their own devices, many investors buy high and sell low. An adviser can provide objective discipline and help an end investor to avoid the noise and behavioural instincts, and improve their overall financial position. We think that the value that an adviser provides their client maybe as much as 1.8% p.a. of additional return on their investor’s portfolio.

Investors look for patterns in the stock market Based on a US analysis of how the average individual equity investor’s portfolio performed over the past 30+ years, our study indicates that the “average equity investor1” would have underperformed the Russell 3000 Index.

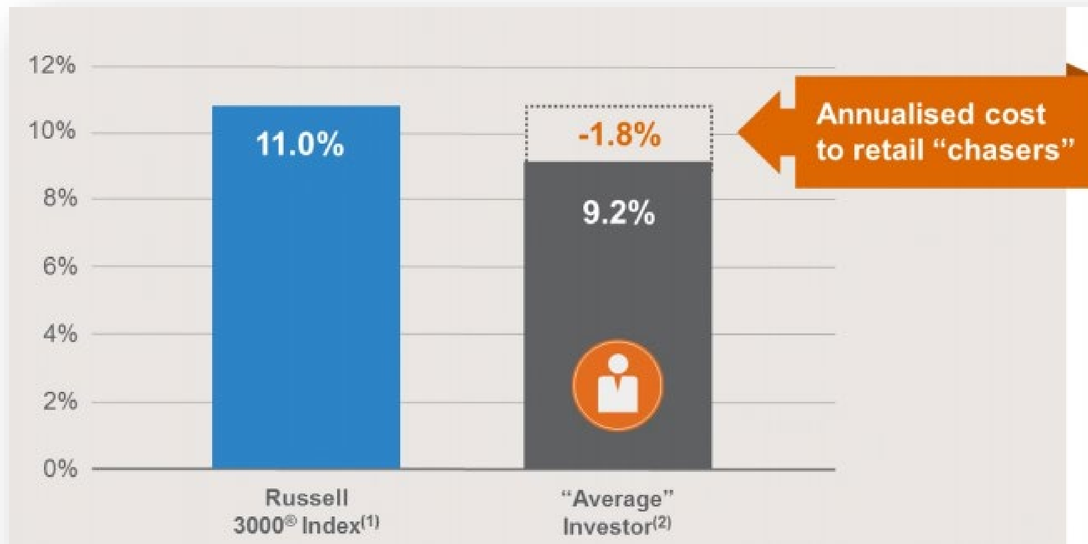
From 2009 to 2013, US investors withdrew more money from U.S. stock mutual funds than they put in. All the while, the Russell 3000® Index climbed 84% over those four years. For those that chose to stay in cash since the market bottom on March 9, 2009 to the end of 2017, they missed a cumulative return of over 380%, based on the Russell 3000® Index (refer to graph immediately below).



[1] “Average” US equity investor is based on general cash-flow trends as measured by the ICI compared to the market's overall performance.US mutual fund data was used as robust global or Australian historical data is not currently available.

Source: BNY Mellon Analytical Services, IFIC, Russell Investments. Based on annualised returns from January 1, 1984 to December 31, 2017. Return was calculated by deriving the internal rate of return (IRR) based on ICI (Investment Company Institute) monthly mutual fund net new cash flow data which was compared to the rate of return if invested in the Russell 3000 Index and held without alteration from January 1, 1984 to December 31, 2017. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.

(1984-2017)



(1) BNY Mellon Analytical Services, Russell 3000® Index annualized return from January 1, 1984 to December 31, 2017.

(2) Russell Investment Group & Investment Company Institute (ICI). Return was calculated by deriving the internal rate of return (IRR) based on ICI monthly fund flow data which was compared to the rate of return if invested in the securities of the Russell 3000® Index and held without alteration from January 1, 1984 to December 31, 2017. This seeks to illustrate how regularly increasing or decreasing equity exposure based on the current market trends can sacrifice even market like returns.

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The bottom line... We believe advisers can play a critical role in helping investors avoid common behavioural tendencies and may potentially help their clients achieve better portfolio returns than those investors making decisions without professional guidance.

2. Tax-aware planning/ investing can potentially amount to 0.9%-1.2%p.a.

Providing a more tax-aware approach is an area where advisers can distinguish themselves and demonstrate some of the more specific advice strategies that can deliver real gains to an end investor.

For example, most people are familiar with the concept of Superannuation and many are familiar that there are tax benefits associated. However, the technical expertise of how to make the most out of your tax circumstances in regards to super is considered daunting. Not to mention the fear of getting it wrong and being answerable to the Australian Taxation Office. Advisers can provide expert guidance on choosing appropriate tax-aware solutions and strategies that can deliver meaningful value to your clients.

For example, tax-aware advisers can add value for their clients by:

› Considering investment solutions that actively implement tax-aware strategies such as lower turnover styles, tax-minimisation overlays and centralised portfolio management.
› Tax advice through superannuation contribution strategies (salary sacrifice and transition to retirement) and reinvesting tax savings
› Insurance premium – identifying tax deduction benefits in super and reinvesting these tax savings.
› Optimising tax for non-superannuation assets and managing 'tax surprises' as regulatory changes occur (e.g. recent superannuation legislative changes)

We believe that the value of an adviser for Tax-Aware investing is at least the sum of:
› Tax effective investment strategies
› Salary sacrifice pre and post superannuation contributions (depending on account balances)

By reference to our study and the above considerations we estimate this to be between 0.9%-1.2%p.a., depending on whether the client is in accumulation or transition to retirement phase, based on average balances.

3. Valuable time and peace of mind (variable % p.a.)

While some benefits of a financial adviser are more easily quantifiable, such as using historical data to model investor behaviour or tax aware techniques, other benefits are more subjective and dependent on individual clients.

Many people identify as being time-poor, and as a result people are outsourcing more and more of their personal needs. It could be having a house cleaner, dog walker, home delivered groceries – whatever it might be to save time on the things we don't enjoy, and create more time to do what is important to us. So financial advisers not only deliver investment value – but also give clients back more time in their life in two further ways:

a) The financial administration burden – quantify time saved

A financial adviser may provide value in creating a financial plan in less time (and with more expertise) than most investors could do on their own. Beyond the creation of a plan, think about the time you may save by working with an experienced professional to help you monitor and make recommended adjustments to your investments, ongoing savings and contributions and ensure you have the right insurance in place.

A financial plan is a key element in helping investors identify and reach their goals. But there is a lot of research and knowledge that goes on behind the scenes. Consider the time taken to:

	How many hours would this take you?
Identifying your goals, circumstances and preferences - what are your personal goals? How do you translate that into financial goals?	
Centralising and evaluating your overall financial position - understanding your current wealth position including superannuation accounts, insurance, personal or business bank accounts and mortgages, insurances, Centrelink needs. You may have offshore super or have unique family circumstances to consider.	
Modelling your retirement position - based on your current balance, income, age and what your retirement goals are, identify whether you are on track or what you need to do to be on track. Whether you are 22 or 82, everyone can benefit from retirement advice.	
Reviewing your current budget and savings plans	
Knowing what investment, platform and insurance solutions are out there - There are thousands of investment solutions available to choose from Advisers have access to specialist tools to evaluate and identify which of those is best for your needs.	
Documenting a plan and managing your financial paperwork - delivering a consolidated plan report of what you need to know and what, if anything, you need to do.	
Implementing a plan - this is the time taken to fill in application forms to set-up investment portfolios, apply for insurance, manage the follow up paper work and other administration needs.	
Reviewing and tracking to your plan - once you have a plan, you need to ensure that what you put down in the plan is still relevant overtime. Have any of your circumstances changed, are you still in the right investments, do you need to save more, increase your insurance, etc.?	
Total Hours:	

NOTE: a detailed list of services that may or may not be included in the fee charged is always provided.

In considering the hours it would take clients to take these steps it is also important to think about the knowledge needed to do it successfully. And that is just coming up with and managing the plan.

While we don't like to consider what could go wrong, what happens in the event they need to claim on their insurance, or they go through a redundancy or a family issue that changes their financial circumstances? Advisers can take much of the burden in these times of crisis allowing their clients to focus on the things that are important to them.

The value of an adviser in helping clients with their financial planning is the combination of the time, skill, inclination, or finances to look after all these aspects for them.

b) The "Peace of Mind factor"

It may be hard to quantify and may be subjective for each client, but there is also the "Peace of Mind" factor that advisers can provide clients. The first part is assisting in identifying a client's goals. The second part is helping clients know that the adviser has helped them consider everything to make the most out of their financial position and maximise their financial security.

For many clients, this might translate into less sleepless nights, finally getting the will or super consolidation done that they have been meaning to do or having the reassurance that they are taking the right actions. It might be the comfort in knowing what their aggregate financial position is, and what financial steps they need to take to achieve their personal goals.

Trying to do this on their own can be challenging and daunting for many clients. The key value that an adviser adds is to help clients remove that doubt of "I don't know what I don't know", and give clients confidence and security that they have the best preparation possible

What about limited, automated or robo-advice?

There are other advice services, often technology driven. While this can be a tool to provide advice on a single part of a client's financial circumstances, it is inherently limited in what it can offer.

For example, robo-advice may provide advice on Superannuation, but it is not taking into account what clients own outside of super, other investments, debts, health or family circumstances and therefore is not considered holistic advice or providing a full picture of their financial position. It is also only as good as the technology behind it. An adviser's personal relationship in understanding and articulating their client's unique goals, keeping them disciplined, adapting to changes in their whole life and building a longer term trust relationship is the true value of having an adviser.

The bottom line

Advisers delivering services and value above and beyond investment-only advice may have an estimated contributory value of around 3% or more. By demonstrating to clients how this value exceeds the fee charged, advisers can improve client satisfaction at a time of record volatile markets and likely rising interest rates. Likewise, this value is a meaningful differentiator in a time of margin compression, regulatory scrutiny, and demographic change. Given that clients are an adviser's most persuasive advocates, helping them understand the value provided is key.

At Russell Investments, we believe in the importance of advisers. We see the advantages that advisers create for their clients.

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