

COSTS & VALUE FOR MONEY

The private investor needs to understand that the financial services' industry is not as cost effective nor is it as efficient as it should and could be.

Investors need to know how much they are being charged and whether their advisors are adding value.

If there is no central structure for the management of your financial needs and your assets, it is possible that you may be receiving inappropriate and costly wealth management advice. It is certainly impossible to be cost effective without this.

- Investing in equities and fixed interest investments without regard to the size and timing of financial needs can cost substantially more than the additional planning costs of an integrated strategy.
- Managing assets without regard to future needs can also have significant financial repercussions.
- Conducting estate planning and insurance and overall financial planning without regard to the client's future asset liability relationship can incur significant additional costs.

In fact, you may even have low charges on your assets and good performance, but inappropriate structure will cost you.

Likewise, if your manager is not paying attention to the risks investments pose to the ability of assets to meet needs over time, this may also cost you.

But how do you assess how much you should be charged and, what value benchmarks should you be looking at?

If the consequences of the advice you are receiving is costing you, then you must seriously question the advice you are receiving.

Cost components

We can break the components of the wealth and asset management process into specific components and we can assign costs to each of these components. These components are stock selection, asset allocation, personalisation & planning and management.

Stock selection

Stock selection is the primary component of active asset management. If a mutual fund or an Exchange Traded Fund is purchased, this component has been delegated and your advisor cannot and should not receive a return on that component.

Asset allocation

This is where stock selection is delegated (mutual fund or ETF is used) and the manager decides the allocation to styles, market components and global markets. Proper asset allocation, like stock selection, is derived from a valuation framework, itself determined by an investment style.

Third party asset allocation tools and services represent delegation of asset allocation. What this means is that someone else works out the asset allocation. In this case your advisor has also delegated the return on this component, which means he or she should not be charging you for it.

If an asset allocator is taking a passive approach to allocation, then he or she must reduce this premium via the selection of index fund components and also charge a lower fee for their service.

If your advisor has delegated asset allocation and stock selection, they cannot earn a return on these two components.

Many advisors do not do the stock selection, the asset allocation, or the actual management, yet, they receive the same return per unit of funds under management that most asset managers receive and, more if we include the up front commission.

Personalisation & planning

This is the personalisation of portfolio structure to client risk aversion and liability profiles.

Portfolios should be constructed in accordance with the interaction of client lifetime financial needs (liability) and risk profiles and a firm's investment strategy. Portfolios should exactly reflect client needs, preferences and expectations and protect financial needs against significant risk at all times.

Inappropriate portfolio structure can result in unnecessary transactions at critical points in the stock market and economic cycle, affecting return, increasing risk and costs. Appropriate portfolio structure can significantly enhance long term total return, reducing costs and risk.

If this component is not being managed, then the advisor cannot charge a fee for this component. Whether this component is being managed can be assessed by analysing a firm's portfolio construction methodology and their historical and planned portfolio transactions.

It is debatable whether many investment and financial advisors are effectively and actually managing this component. If not, what is the investor paying. Well the investor is paying for the distribution costs of the products and services they receive.

Management

This is the management of the portfolio structure determined by stock selection and/or asset allocation and personalisation and planning. If you do not determine either stock selection or asset allocation you cannot be rewarded for the management of the portfolio. Working out what an advisor is doing and is not doing is easy for TAMRIS, but a complex process for the individual investor.

Component costs

Efficient costs should really be closer to the following.

- Stock selection; between 0.25% and 0.75% for active investment in the broader market and between 0.5% and 1.25% for the management of specialist and overseas sectors.
- Asset allocation; between 0.1% for passive global indexing and 0.25% for global active allocation.
- Planning and personalisation; between 0.25% and 0.5% of assets depending on level of personalisation and planning.

Clients who are receiving passive and indexed asset management should receive the index component costs; ETF (0.1% to 0.5%), asset allocation (0.1%), investment planning (0.5%) to a total of 0.7% to 1.1%.

Clients whose risk preferences can accept active strategies would have a higher cost base, 0.5% to 1.25% (active management), asset allocation (0.25%), investment planning (0.5%), or a total between 1.25% and 2%.

The above represents basic costs before sales and services taxes and represent the type of cost structure an organisation with reasonably efficient business processes and integrated software systems should be capable of producing.

On line service offerings should in future be able to provide much lower costs for total asset life cycle wealth management as would a more efficient market place for collective investment vehicles such as mutual funds, investment trusts and other vehicles.

Integrated costs

Portfolio planning and personalisation should take into consideration all financial needs and objectives.

Effectively the amount of time it takes to conduct estate planning, insurance and general financial planning should be cut by integrated asset and financial management service processes.

If your advisors are conducting estate planning, insurance, pensions, school fees or other work without an integrated analysis of your needs and assets over time, you may well be incurring additional charges and costs.

When you add up the total costs of all advice, transaction charges, fees and the financial consequences of inappropriate portfolio structure, this is where you arrive at the actual cost of wealth and asset management.

If your advisor is not telling you how much he is or not being paid in all areas, including commissions and fees you are probably with the wrong advisor. Your advisor should clearly spell out the total cost structure and they should be aware of the integrated costs of all your financial relationships.