

Asset Management Expertise

The expertise required of the financial professional depends on the nature of the job at hand.

If you have handed your money to an asset manager for a specific objective, such as an allocation to smaller companies, then "all you require" is that the manager has the necessary expertise, resources and track record for managing smaller companies. Assessing whether they can do the job is a "relatively simple exercise" of assessing investment expertise, discipline, resources and performance.

If your money is being managed to meet the more complex objective of meeting your financial needs over time, then the wealth manager must meet standards in each of the following areas.

- Investment discipline and expertise in security selection and asset allocation.
- Expertise in portfolio construction and management to manage both risk and return and liability risks at a point in time and over time.
- Short and long term financial modelling and assumption generation.
- Education, risk assessment and risk profiling.
- Communication and reporting.
- They must be cost effective and add value.
- They must have the systems and the necessary system's expertise
- The ability to provide or coordinate an effective integrated solution.

Whatever the objective of the wealth and asset manager, there is always a relationship to the whole. As such, someone needs to be in charge of the overall management and allocation of assets and their relationship with the management of financial needs over time.

To be able to construct a portfolio to meet client financial needs over time, the advising firm needs the expertise in the following areas.

- Investment discipline, valuation, allocation and management expertise and the resources needed to deliver this.
- Portfolio expertise, the ability to structure, plan and manage the portfolio to meet financial needs over time. Relating the structure of assets to meet financial needs over time is different from managing assets to manage risk and return at a point in time.
- Modelling expertise, the ability to model the risks as well as the returns to the ability of assets to meet needs over time.

Investment Planning Expertise

All investment planning involves an optimisation problem. How do you allocate assets and manage assets to meet short and long term financial needs while protecting the client from risk and optimising the returns on the portfolio for a given investment style and client risk and performance preferences?

These decision rules are different from the rules that determine the structure and management of a portfolio without financial needs. They determine amongst other things the following.

- How low risk assets are allocated and structured to [protect financial needs against significant risk](#).
- How low risk assets are structured to meet financial needs as and when they arise.
- How central investment strategy for low risk investments is personalised to individual client financial needs and risk preferences.
- How the central investment strategy and discipline adjusts its equity investment strategy for client yield requirements, risk aversions and performance preferences.
 - For example, how is the allocation to market cap, global markets, growth and or value, defensive or aggressive investments adjusted for the universe of financial needs and risk preferences.
 - While many asset managers do have a one size fits all, this is not necessarily the case.
- The optimum balance between equities and fixed interest investments, its relationship with risk aversion and its rebalancing of the portfolio over time.
- The application of future surplus income and capital to the portfolio; this can have a significant impact on portfolio planning.
- How initial investment strategy is adjusted for market and economic valuations and how risk aversion and financial needs affects this decision; some clients coming from cash, some are already invested, others have significant financial needs while others have none. These are all factors which affect not only the initial investment decision but the ongoing management of the portfolio.

The only way investment planning can be effectively managed is through sophisticated systems that automate and dynamise the complex process of personalizing the construction, planning and management of assets to meet financial needs over time.

The Benefits of Investment Planning

Long term return is influenced by the underlying return on investments, the management of investment, the costs of investments and the management of inflows to and outflows from the portfolio.

A portfolio which is able to use inflows to and outflows from the portfolio to enhance the management of risk and return is capable of increasing total return above that provided by the underlying return on investments. One which cannot is liable to reducing return below the underlying return.

You should never be forced to sell a long term asset to meet an immediate need. If your portfolio is structured without proper long term planning, you will be forced to sell investments which may be at a loss. Additionally, without a proper portfolio structure it is impossible to efficiently recycle capital from areas of lower return to areas of higher return.

A properly constructed, planned and managed portfolio can actually be a significant source of return, can reduce portfolio transaction costs and can reduce risk.

Modelling Expertise

Modelling the ability of your current and future assets to meet your present and future financial needs and objectives over time is a **primary function** of any wealth manager.

The objective of modelling should not be to forecast how much capital you will have at a certain point in the future, but to assess the ability of your assets to meet your needs and objectives irrespective of stock market and economic risk.

This means the return assumptions used should already have been hit with stock market crashes and recessions as well as risks of higher inflation. What this means, is that irrespective of stock market crashes and recessions, the ability of your assets to meet your financial needs should not be affected by risk. In fact, even during long periods of stock market declines you should be able to increase your financial needs in line with inflation.

A precursor to effective modelling and planning is a portfolio structure which is able to manage risks and your financial needs.

The problem with most industry modelling is that it is not actually backed up by a portfolio capable of managing short terms risk.

The second major problem is that quite often the return assumptions used do not reflect the risks of the stock market and economic cycle.

At the top of the last bull market in 2000 many industry standard assumptions were strongly positive going forward. In fact, the return assumptions should have been strongly negative.

This is a common feature of many standard retail wealth management software and is a key reason why many individuals' financial security is adversely affected during stock market downturns.

Expertise needed to model the long term returns of assets over time includes the ability to value both the economic and the stock market cycle. Analysis of the variability of past returns should not be relied upon as a guide to future returns.

A great deal of academic research is focussed on this particular area, although this is almost entirely focussed on institutional pension fund management. The major weakness as far as the asset management industry is concerned is its inability to seriously consider the risks to the ability of assets to meet future financial needs. For asset managers there is little personal consequence from getting the forecast returns incorrect.

While financial planners often have significant expertise in the use of compound interest calculations, most financial planning modelling is not backed up by the necessary portfolio structure and asset management expertise.

One insight into the industry is this. Asset managers tend to view the long term investment planning as a financial planner or investment advisor function.

TAMRIS has significant expertise in this particular area and has wide knowledge of industry techniques from the basic to the most advanced techniques currently used in institutional asset liability management.

Please see Asset Liability Modelling in the technical section for further information on modelling and return assumption generation.

Investment Expertise and Resources

You do not need the resources of a large financial institution to be able to fund the research needed to support an asset management operation. The amount of resources does depend on the type of investments your advisor uses to allocate your assets.

Direct stock selection requires the most resources. Companies who intend to select stocks in all areas of the domestic market and global market place require the greatest resources.

But companies do not need specific stock selection expertise in all areas providing **a)** they can allocate to the market component they want at cost through an efficient vehicle and **b)** they can actually value the market component they want to allocate to.

Those who allocate to market components (small, medium, large, value, growth, income, recovery, special situations, themes and sectors) require a lesser amount of resources since the higher cost of stock selection has been delegated away mutual funds or exchange traded funds.

The most basic requirement of any asset manager is that they can value the markets, the areas of the markets and the securities or funds they are invested in.

- If you cannot value, then it is impossible to determine how much you should invest and when and how much you want to sell or buy.
- If you cannot value a market then you cannot assess the risks to the ability of assets invested to meet financial needs over time. If you cannot value then you cannot assess the risks to return over time either.
- If you cannot value, you cannot buy low or sell high, the most basic ability in the financial services industry.
- If you cannot value then you cannot construct a portfolio of investments, nor can you manage risk or return.

Much of the financial service's industry is organised around the precept that it is asset allocation and not security selection or timing that is the most important component of return.

Unfortunately, if you want to manage risks to the ability of assets to meet financial needs over time, you cannot allocate without being able to value. It is a critical misconception because it has allowed armies of advisors without valuation expertise to deliver portfolios constructed by systems without a valuation component.

Being able to select the best performing mutual funds to provide the portfolio allocation does not constitute investment expertise, nor does it constitute sufficient resources to manage portfolios. A mutual fund or ETF is only an asset allocation vehicle designed to access an area of the market or a market that you want to allocate for valid valuation reasons.

Anyone using mutual funds and exchange traded funds needs to be able to value markets, their components and the underlying economies.

Independent analysis

As far as the management of an individual's financial security is concerned, an organisation needs to be able to provide independent analysis of markets, securities and their risks.

It is difficult for many financial institutions that depend on transactions for their remuneration to take an independent view on the market.

Companies that do not trade stocks or make market in stocks or help bring stocks to market are more likely to be able to provide independent valuation analysis. But even here, true independence is the ability to think independently of the rest of the market in making decisions regarding valuation and risk.

Independent analysis is of critical importance where the advisor or company is charged with the management of both assets and financial needs. Decisions need to be made with respect to these risks to short and long term financial security.

Investors therefore need to ask this one question. What is driving the analysis, the advice and the recommendations they are receiving?

These questions need to be asked in particular where the advisor or company is using third party software, third party research and third party asset management.

Portfolio construction expertise

Specific expertise is needed to construct, plan and manage portfolios to meet financial needs over time.

- At one level, the portfolio needs to be able to provide a balance of risk and return at a point in time, a balance which needs to be personal to the client's financial needs and risk preferences.
- At another level, a portfolio needs to be able to meet financial needs over time, to meet these over time and to manage risk and return at all points in time.
- At another level the portfolio needs to take into consideration future inflows (income and capital) to and future outflows (income and capital) from the portfolio within the asset allocation structure, decisions which cannot be made without systems that manage this complexity.

The structure and allocation of the portfolio needs to take into consideration your needs today and your needs tomorrow balancing risk and return at all times.

The only way expertise can be distributed to the client is if the asset allocation and portfolio construction expertise is automated. It is impossible to construct plan and manage personalised portfolios to meet needs over time without a discipline that defines the rules that govern the construction, allocation and management of portfolios to meet financial needs over time. These are investment planning disciplines.