Total Asset, Life Cycle, Wealth Management

Total Asset, Life Cycle, Wealth Management is the management of total financial needs and total financial assets over an individual's lifetime.

All financial advice, whether it be insurance, pensions, estate and general financial planning, depends on the amount of capital an individual has both now and in the future and the relationship between that capital and lifetime financial needs.

Since the amount of capital a client has and will accumulate determines the need for all financial services, **no financial advice, let alone a product,** can effectively be given without a total asset life cycle wealth analysis.

Of all the elements of financial services, the management of assets is the most complex and, the most important to the management of long term financial needs.

To manage assets to meet lifetime financial needs, assets need to be structured to meet these needs as and when they arise.

Assets also need to be managed to balance risk and return not just now, but for all future points in time where financial needs are arising, at the same time. An apparent and impossible juggling act without the disciplines and systems to do the job.

To do this, the advisor needs to know all planned income and capital expenditure and the disposition of all existing assets as well as future additions to assets from savings and capital.

If a portfolio is truly personalised, the amount allocated to low risk assets (to cash, to fixed interest and specific maturities) and to equities (to each global market, to each specific market allocation, market cap, style, yield) should be unique to each client.

There should be no rigid model portfolio.

In addition to investment expertise and the resources needed to fund a central investment resource (economic, market and security research, domestic and global strategy, asset allocation and risk management) advisors need the expertise and systems able to do the following.

- Model and manage the ability of assets to meet needs over an investor's lifetime.
- Protect financial needs against significant stock market and economic risk at all times – no client should ever be affected by natural significant risks such as stock market crashes and economic recessions.
- Optimise the balance between risk and return over time and at a point in time given the client's financial needs, risk preferences and stock market and economic risk.

Every client's financial needs, existing assets, preferences and size and timing of portfolio inflows (savings from income and capital) and outflows (income and capital expenditure) are different and have a direct and unique impact on portfolio structure, planning and management.

Total asset, life cycle wealth management demands total personalisation for each and every investor as the most viable way of efficiently managing risk and return.

The technology and the expertise needed to deliver high quality, low cost, personalised asset and wealth management services to the individual investor exists. Personalisation should no longer be a byword for complexity, time and cost but an easy to deliver “must-have”.

If the portfolio is structured properly, if the assumptions used to plan for your future security cover significant risks your portfolio should be capable of dealing with virtually all natural and significant market and economic risks.

Asset Liability Modelling and Management

In order to be able to provide for and manage both short and long term financial security, a portfolio needs to be constructed around planned lifetime financial needs.

This demands three key things.

- The ability to model the investor’s net financial needs (all income and capital expenditure less all income and capital received) over time.
- The ability to construct a portfolio directly around these needs and to model the interaction of portfolio structure and needs over time. This requires investment planning and modelling expertise.
- To protect the ability of assets to meet financial needs irrespective of significant stock market and economic risks.

Simply forecasting asset returns and then deducting needs from the forecast future capital does not manage risk nor does it structure portfolios to meet needs irrespective of risk. This is a simple or **naive solution**.

The menu at the side provides basic information on important aspects of asset and liability modelling and management for the individual.

For further information please see the asset management expertise required by your wealth managers to deliver total asset life cycle wealth management and for those who want a more in depth assessment please see the technical perspectives in the news and technical sections.

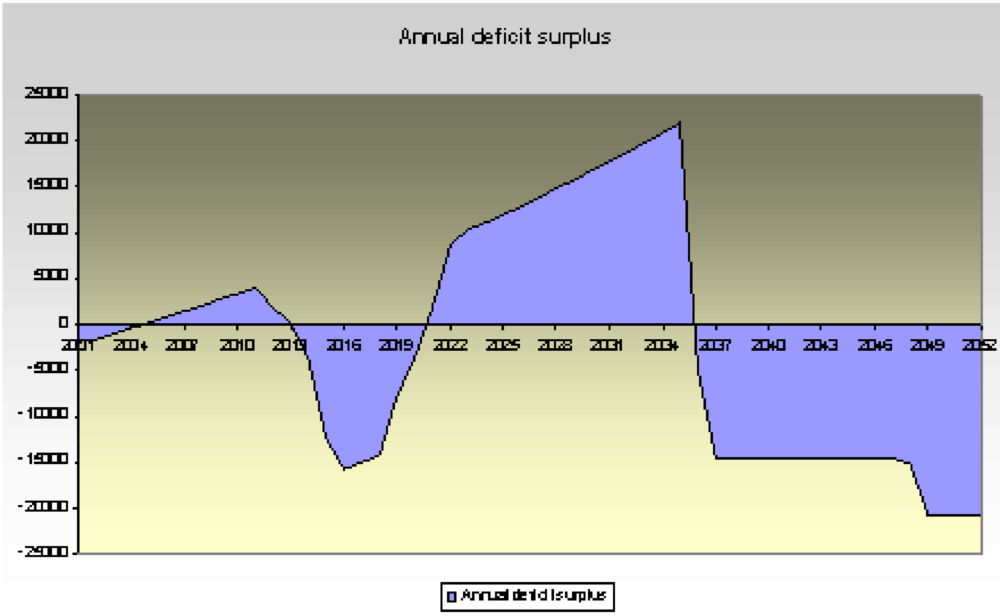
Liability Modelling

This is the modelling of an individual's financial needs over time and requires the following information.

- **Present and future expenditure needs** - current expenditure, planned expenditure in retirement.
- **Present and future sources of income** - earned income, expected pensions, rental income etc.
- **Size and timing of future liabilities** - cost of replacing cars, large holidays, home renovations, weddings, schooling and university, tax, property purchase.
- **Size and timing of expected future capital** - inheritance, maturing life policies

This information is fed into a financial model. Out of this model comes a profile of the individual's long term financial needs.

The profile shows either a surplus (income and capital added to portfolio), or a deficit (income and capital to be withdrawn from the portfolio) and is the most important determinant of portfolio structure. It should also be in today's money.



This profile is important in that it allows you to bring all an individual's financial needs together. Structuring a portfolio based on one profile is much easier. Centralizing the management of all assets and all needs is also the most effective method of managing risk and return.

Why?

All objectives combined and can be managed within the one centralised portfolio structure. This is simpler, more cost effective, more efficient than the segregation of school fees, retirement planning and income drawdown and the associated individual planning, calculations etc.

But, the ability to do so requires a system that can integrate the management of assets and the management of financial needs. If your manager does not have such a system the only way they can deal with each objective is to run each portfolio separately.

Income and capital security

For those who are living off their capital, the ability to provide income and capital security from their portfolio, irrespective of stock market and economic risk is critical, as is the ability to increase income and capital needs in line with inflation.

You cannot realistically provide income and capital security without managing or at least knowing the disposition of all assets and needs and modeling their interaction.

Within a properly constructed portfolio, stock market crashes, bear markets and recessions should have little or no effect on the ability of a portfolio to supply planned income and capital needs.

Periods of significant investment risk occur every 10 to 15 years. After such events it can take between five and ten years for the return on equities to match the return on lower risk assets and, sometimes considerably longer - this is before transaction costs and management charges.

A 60 year old is likely to experience two to three such events during his or her portfolio's lifetime!

How an organization structures its portfolios to meet an investor's financial needs is critical. If your manager has to sell investments on an ongoing basis to meet your financial needs, your portfolio may well be exposed to significant risk and the risks to financial security this would pose.

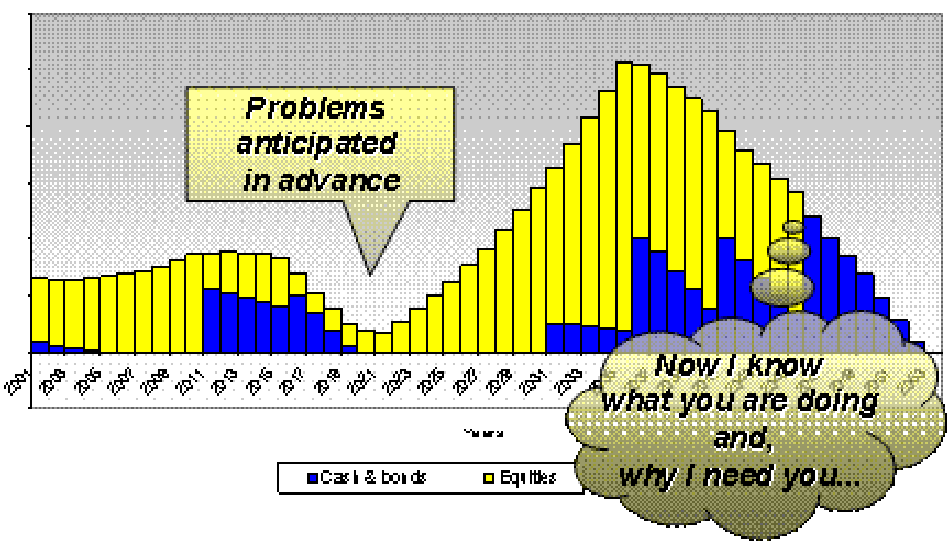
A well structured portfolio should be able to meet income and capital needs without forced sales for years. What this means is that the portfolio needs to be structured to meet needs years in advance which requires sophisticated modeling and management of assets and needs over time.

Long term financial security

Long term modeling of your assets and financial needs assesses the ability of your portfolio to meet short and long term needs irrespective of natural financial and economic risks; recessions and stock market crashes or bear markets are natural risks and are certain to happen.

Is there enough capital to support lifetime income and capital expenditure? Can he or she meet school fees, retire at 60, purchase a holiday home, leave capital to children. If not, what course of action should be taken?

Many investors may also risk depleting capital over time . Modeling the ability of assets to meet needs is key to the management of this risk and to educating the client over the consequences and risks of their financial decisions.



This long term modeling is also a framework against which an investor can make realistic investment and lifestyle decisions. It is the investor through his or her objectives and risk aversions that selects the portfolio, not the advisor or portfolio manager.

What many fail to appreciate, is that you cannot structure a portfolio, or plan for the needs of an investor at each point in time without first assessing needs over the client's lifetime.

Decisions regarding your portfolio and what you decide to take from it cannot be made on a day by day basis.

This type of modeling is more advanced and involved than traditional simple compound interest calculations. If done properly, stock market crashes and economic recessions should not impact on your financial security. This of course depends on your advisors investment planning discipline and the assumptions he or she uses in the modelling and management of your financial assets and financial needs.

It is critical that where modelling of the ability of your assets to meet needs is provided, that the assumptions that are used to do this analysis are provided and, that the assumptions can cope with economic and stock market risks.

Much modelling prior to the 2000 to 2003 bear market failed to take these risks into consideration.

This is actually a much more complex area than many people think it is. Assessing whether your advisor is delivering in this area is most probably outside most investors' ability to discern.

Return assumptions

In order to minimise the risks to future financial security not being met, conservative risk and return assumptions should be used for modelling the future return on stock market investments.

These projected returns should reflect the current risks in the economy and market place, as opposed to the historical risks and returns on which most retail modelling is based. Additionally returns should also be hit with future economic and market risk.

The benefit of this approach is that stress testing has already hit future return with stock market and economic risk enhancing long term income and capital security.

Effectively when the S&P 500 hit its lows in 2002, your advisors should have been able to rerun their modelling analysis and come up with little or no change to the ability of your assets to meet your needs.

Unfortunately, many software systems and financial institutions have tended to use projected returns which do not fully accommodate the risks to returns. As a result, many investors find that they have to scale down the income and capital they can take from their portfolio following market declines and economic downturns.

Return assumptions for low risk investments should also be capable of protecting planned security against significant interest rate and inflation risk.

Essentially, a portfolio should be able to cope with significant financial risks and still be able to provide the financial security planned at outset. This can only be achieved through sensible financial modelling and a portfolio structure which is directly related to meeting financial needs irrespective of risk.

Total financial assets and needs

Total assets include all cash balances, fixed interest securities, equities, mutual funds, life insurance with investment content, pension funds and other products and investments held.

Future assets include amongst others, inheritances, capital from all sources, for example capital that could be raised from property to fund expenditure.

If your advisor does not know the disposition of all assets he cannot realistically meet or manage your financial needs nor manage the risks to the ability of your assets to meet your needs.

The size and timing of income and capital expenditure will impact on the amount in cash and the maturity structure of lower risk investments.

Have you too much or too little cash, too much fixed interest securities and, do these mature at the right time?

If your main advisor does not have knowledge of all your stock market investments, you risk under or over allocating to a market, sector or security, exposing yourself to undue investment risk.

Your advisors should not be structuring your portfolio on current needs and assets without assessing the impact of future needs and assets on its structure. You can only do this with a structure that directly relates current and future needs to current and future asset allocation.

If financial needs determine structure, then without knowledge of future needs you cannot construct a portfolio personalized to meet them.

Managing all investment assets (or at least knowing their disposition) and lifetime needs allows your advisor to balance the management of lifetime financial security and lifetime financial risk and return.

Managing all assets and all financial needs is not always within the mandate or the capability of the individual wealth or asset manager. Ascertaining what a manager can and cannot do is therefore important.

Further reading, please see the management of total financial asset and total financial needs in investment basics.

Risk Profiling and TALCWM

Total Asset, Life Cycle wealth management manages the relationship between financial needs and financial assets over time.

This is in fact the most important relationship as far as risk is concerned. Relating portfolio structure to financial needs actually simplifies the risk assessment process;

a. because the size and timing of financial needs are personal to the investor,

b. both the need for low risk assets and the preference for low risk assets is directly and primarily related to the size and timing of an investor's financial needs,

c. because the nature of asset class risk and return changes over time, there is also a direct relationship between asset allocation and the size and timing of the financial demands on a portfolio's assets.

Because managing total assets and financial needs directly relates portfolio structure to financial needs, it directly also relates risk assessment to the amount of financial security an individual investor wants and needs from their portfolio.

If a portfolio is constructed to meet financial needs, then the derived asset allocation, as a basic minimum, should be sufficient to protect income and capital needs against these significant risks and this financial security can be easily illustrated and communicated to the client.

If the investor wants more security and greater protection against short term stock market and economic risks, then they can easily choose and make a more informed decision.

Because there is a direct relationship between financial needs and the yield, liquidity and volatility risks of the equity portfolio, the investor will also have also have a reference equity portfolio suitable to their needs; providing the asset manager is able to relate portfolio structure to financial needs over time. If they are more aggressive or more conservative then they can use this portfolio as a reference point for adjusting the equity portfolio selected .

Risk profiling is one of the more complex areas of the wealth management process. It is also one of the areas of least expertise and greatest practical weakness. Few if any financial advisors have enough expertise in risk profiling and risk assessment and fewer still fully understand the actual risk assessment procedures being used in the industry.