Value of an advisor is still more than 1%

As a follow up to my previous blog post on the value of an advisor, I wanted to provide you with even more evidence that suggests your advisory fee is a very good deal for the value you deliver to your clients.

Since the financial services industry loves numbers, here is a new formula you might consider for the value of your advisory services:

\[ A + B + C + P > \text{Your fee} \]

Now that I have got your attention, let's look at each individual service and place an approximate value on it. Doing this, we will be able to break down the true value you deliver in the form of comprehensive investment and planning services to your fee-based clients.

For simplicity purposes, all estimates are based on a $500,000 fee-based portfolio… here we go!

**A= Annual rebalancing of investment portfolios**

Most individual investors do not set a rebalancing policy when they manage their own investment portfolios. Investors who do consider establishing a rebalancing policy are often affected by the unreliable emotional decision-making impulses that can result in buying recent winners and selling recent losers.

Russell conducted a rebalancing policy study in 2011, which highlighted the fact that advisors who establish a consistent rebalancing policy for a client have the potential to add incremental return to portfolios while reducing the volatility of the return pattern.

Rebalancing comparison – July 1996 through September 2011

<table>
<thead>
<tr>
<th></th>
<th>Buy and hold</th>
<th>Annual Rebalancing</th>
<th>Quarterly Rebalancing</th>
<th>Monthly Rebalancing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annualized Return</td>
<td>5.92%</td>
<td>6.85%</td>
<td>6.50%</td>
<td>6.43%</td>
</tr>
<tr>
<td>Annualized Standard Deviation</td>
<td>10.35%</td>
<td>10.06%</td>
<td>10.10%</td>
<td>10.23%</td>
</tr>
</tbody>
</table>

So, what is the value of an advisor setting an annual rebalancing policy that a client is likely to stick with? Based on this example, you could say it is:

**A= 0.93% in additional potential portfolio return by establishing an annual rebalancing policy**

**B= Behavior mistakes by individual investors**

Russell conducted an analysis of how the average individual equity investor's portfolio performed over the past 29 years relative to stocks, bonds, gold, inflation and other investment options. The data revealed that the "average equity investor" underperformed the Russell 3000® Index by 2.2% annually.

Take a look:
(1) BNY Mellon Analytical Services, Russell 3000® Index annualized return from January 1, 1984 - December 31, 2013. (2) Russell Investment Group, Strategas & 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 Russell 3000® Index and held without alteration from January 1, 1984 to December 31, 2013. This seeks to illustrate how regularly increasing or decreasing equity exposure based on the current market trends can sacrifice even market like returns. 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.

Still need more proof? The following chart captures one of the most common investor behavior issues: the impulse to buy high and sell low.

Advisors are extremely valuable in that they can be the behavior coach who helps investors avoid chasing trends and buying during market highs and selling during market lows. Advisors who build a diversified asset allocation plan have the potential to help their clients achieve better portfolio returns than those experienced by the average investors making decisions without professional guidance. Of course, diversification doesn't assure a profit or protect against a loss in declining markets.
**B= 2.2% in additional return potential for investors who can avoid chasing performance**

**C= Cost of basic investment-only management** There is a trend among some financial advisors and firms to offer investment-only management, often without a financial plan, no ongoing service and little to no advice outside of investments. These firms have *set the price* for the cost of an advisor who establishes a risk tolerance for a client and builds a portfolio for them.

Based on my research of the three most popular flat-fee options offered by these firms, the cost of basic investment-only advice is approximately 0.35% on a $500,000 portfolio. (Note: the cost is higher for portfolio less than $500,000 and lower for those over $500,000).

So for advisors, the market has set the price of your investment advice to be 0.35% of your advisory fee.

**C= 0.35% for the cost of investment-only management**

**P= Planning costs or the costs of providing a financial plan, updates and your services**

What is the true cost of a financial plan? According to the Financial Planning Association's 2011 fee study, a financial planner spends about 1-3 hours during the initial discovery meeting with a new client and 3-14 hours on building a financial plan for the client. The *average cost of developing a financial plan* with a Certified Financial Planner is $2,855 with annual adjustments thereafter billed at $200 per hour. (We assume creating and maintaining financial plans are part of the annual fee in this example).

We believe that in order to help investors reach their goals, a financial plan is a must-have? end of story. Top-tier advisors and wealth managers typically update financial plans at least annually and provide ongoing goal and risk tolerance monitoring that continues well after the initial plan is established. Therefore, I believe that the value of both the initial plan and ongoing adjustment to the plan are worth approximately 0.60% on a $500,000 account.

In our experience, advisors consistently underestimate the time, value and peace of mind they provide to their clients through additional services such as coordinating annual tax return preparation, retirement/insurance/trust/college/legacy planning, social security planning and setting up distributions in retirement. Also, add in the coordination of the other professionals your clients interact with and you may quickly arrive at a time-savings on a client's behalf of 20, 50 or 100 hours each year. I would estimate the value of this time to be 0.25%.

**P= 0.85% (0.60% for annual planning and 0.25% for other services outlined above)**

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**The bottom line**

So what is your true value as an advisor? Are you worth more than 1%?

My analysis suggests that if this is true…

\[
A + B + C + P > \text{Your fee}
\]

… the value of your services individually is:

\[
0.93\% + 2.2\% + 0.35\% + 0.85\% = 4.33\% > \text{Your fee}
\]

Granted, this is a hypothetical example based on my research, each advisor's practice may be different. This exercise suggests that you more than deserve the typical 1% fee for advisory services. The next time a client questions that fee, help them understand all that you bring to the relationship and the value of those services.
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