THE VALUE OF AN ADVISOR

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Charlie Munger, vice chairman of Berkshire Hathaway, says, “Price is what you pay, value is what you get.”

No one wants to pay for something they can do themselves. However, there are certain important things we tend to delegate to others — like surgery or flying a plane. Perhaps getting help with your finances is one of them for you.

At our firm, the financial planning and investment approach is based on academic research; we take an evidenced-based approach. I thought I would approach this topic in the same vein — by giving you what the research shows.

In our office, we jokingly use the phrase, “In God we trust; for everyone else we demand data.”

> **GAMMA IS THE POTENTIAL VALUE SOMEONE ELSE CAN BRING TO THE TABLE BY GIVING ADVICE.**

In 2012, David Blanchett and Paul Kaplan from Morningstar Investment Management wrote a paper, "Alpha, Beta, and Now... Gamma." Its purpose was to determine if financial advisors add any extra value. Blanchett and Kaplan defined Gamma as “the extra income an investor can earn by making better financial decisions.”

So, Gamma is the potential value someone else can bring to the table by giving advice. What is the value worth? Morningstar’s research determined it to be 1.82 percent per year.

Their research pointed to fives areas that make the biggest differences in the outcomes: asset allocation, tax efficiency, product allocation, liability-driven investing and withdrawal strategy.

They found a hypothetical retiree could generate nearly 30 percent more income using strategies driven by better financial decision-making, i.e., Gamma.

More recently, a Vanguard study noted an advisor could add "about 3 percent" per year. Vanguard determined advisors result in this addition in net returns by comparing the projected results of portfolios managed using well-known and accepted practices for wealth management with those that are not.

The Vanguard study broke down the value the advisor adds:

- *Being an effective behavioral coach — potential value add: 1.5%*
- *Applying an asset location strategy — potential value add: 0-0.75%*
- *Employing cost-effective investments — potential value add: up to .45%*
- *Maintaining proper allocation through rebalancing — potential value add: up to .35%*
- *Implementing a spending strategy — potential value add: up to .70%*

The findings in the Value of Advice Report from the Investment Funds Institute of Canada (IFIC) were also dramatic. The IFIC study compared a representative sample of advised and non-advised Canadian households drawn from across a spectrum of incomes, assets, and ages

- Within four to six years, households that used advisors accumulated 58 percent more assets than those that self-directed their investments.

- Those using a professional advisor for 7 to 14 years essentially doubled the wealth accumulation of those without an advisor.

- Households using advice for more than 15 years held 2.7 times more wealth than those that did not enjoy professional guidance.

These are net results after taxes and account for the costs of the professional advice.

Of greatest importance, advisors encourage their clients to save twice as much. But advisors also enable clients to develop long-term strategies. They help curb the all-too-human impulse to panic in down markets, or the equally risky tendency to double down on risk when markets surge.

These conclusions are mirrored in the results of the Putnam Lifetime Income Survey, conducted for the past four years. The annual survey involving thousands of American households examines assets including Social Security, home equity, insurance, and retirement savings, and then calculates a "score" that represents the level of income households are on track to replace in retirement.

- Overall, Americans are on track to replace 61 percent of their pre-retirement income, including Social Security.
- Households that use professional advisors are on track to replace 82 percent.
- Those that do not use advice are likely to replace just 56 percent.

A study done by Financial Engines and Aon Hewitt revealed that 401(k) participants who got professional investment assistance in the form of managed accounts, target-date funds or online advice — collectively labeled as Help — earned higher median returns than those who go it alone.

The study, Help in Defined Contribution Plans: 2006 through 2012, examined the 401(k) investing behavior of 723,000 workers at 14 large U.S. employers. It found on average, employees using Help had median annual returns that were 3.32 percent higher, net of fees, than participants managing their own portfolios. If two participants — one using Help and one not using Help — both invest $10,000 at age 45, assuming both participants receive the median returns identified in the report, the Help participant could have 79 percent more wealth at age 65 ($58,700) than the non-Help participant ($32,800).

If you take the time to read these studies, you will note that none of them claim this added value is due to someone helping you pick out the best performing money manager.

The value is derived from other aspects of wealth management: asset allocation, tax efficiency, withdrawal strategies, product allocation, rebalancing, behavioral coaching, asset location and cost-effective implementation of your investment strategy by using investments with lower expenses.

And, these studies don't include the additional value CERTIFIED FINANCIAL PLANNER™ professionals would add in the way of non-investment advice. These experts, besides assisting with your investments, will also make recommendations on your retirement planning, estate planning, risk management/insurance, asset protection, college planning and charitable giving.

Last, but not least, is the annual DALBAR Inc. report, that in part reveals the challenge investors have when managing their own portfolios.

DALBAR reports that for the 20 years ending in 2017, while the stock market as measured by the S&P 500 has returned 7.68 percent, the average stock investor has only earned 4.79 percent — a 50 percent difference.

	Investor Returns[1]					
	Equity Funds	Asset Allocation Funds	Fixed Income Funds	Inflation	S&P 500	Bloomberg Barclays Aggregate Bond Index[2]
30 Year	3.98	1.85	0.57	2.65	10.16	6.34
20 Year	4.79	2.29	0.48	2.13	7.68	5.29
10 Year	3.64	1.78	0.40	1.83	6.95	4.34
5 Year	9.83	4.85	0.05	1.40	14.66	2.23
3 Year	3.42	1.45	-0.23	1.25	8.87	3.03
12 Month	7.26	5.48	1.23	2.07	11.96	2.65

1. **Returns are for the period ending December 30, 2016.** *Average equity investor, average bond investor and average asset allocation investor performance results are calculated using data supplied by the Investment Company Institute. Investor returns are represented by the change in total mutual fund assets after excluding sales, redemptions and exchanges. This method of calculation captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses and any other costs. After calculating investor returns in dollar terms, two percentages are calculated for the period examined: Total investor return rate and annualized investor return rate. Total return rate is determined by calculating the investor return dollars as a percentage of the net of the sales, redemptions and exchanges for each period.*

2. Amended May 1, 2017.

These bad results are attributed mainly to bad investor behavior.

In an April 2014 article for the St. Louis Federal Reserve, Senior Economist YiLi Chen noted that when he examined the period from 2000-2012 with data from the Investment Company Institute, there was a high cost to investors for chasing returns. He calculated this loss to be on the order of 2 percent per year and blamed it on bad investor behavior — buying high and selling low.

In the end, these various studies indicate it is a critical decision as to whether or not you use an advisor.

You may also be interested in our free report, *The 8 Critical Questions You Must Get Answered To Find A Financial Advisor You Can Trust.* http://worthpointeinvest.com/subscribe/

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