WONDERING IF YOUR ADVISOR IS CLUELESS?

Do you make use of a financial advisor and have you ever wondered if your advisor knows less about investments than you do? You might be right. While there are some brilliant financial planners in South Africa there are many brokers working for large businesses who probably know less than you do.

I was recently reminded of this stark reality when I met a married couple that have been using the same advisor for the last 20 years. They met him when the husband left university and he asked his local bank for advice on how to save his money. Over time, their advisor left the bank and started a financial planning business. He has sold them a range of investments, mainly unit trusts, retirement annuities and more recently "education plans". Both the husband and wife are bright and well educated; they were focussed on their careers and spent time working abroad so they trusted their advisor to look after their money.

It was only when their advisor stopped providing them with proper service that they started paying more attention to what he had done with their money. Unfortunately, the result of their investigation was not positive. So the couple (both in their 40's) started educating themselves about money and investments. They read investment books, financial websites and even bought the academic textbook used to educate financial planners at University. All of their readings lead them to one conclusion – their advisor was ethical but he was sending them along the wrong path.

When I started analysing what he had sold them, it became clear that he has no idea what he is doing with investments. It was obvious that he was so afraid of stock market volatility that he invested their money in a range of different unit trusts that were more suited to an elderly widow than two professionals in their early 40's. In addition, when he decided to allocate money to a fund manager, he would buy every single fund offered by the fund manager. As an example, in one Retirement Annuity he would buy the Cautious Fund, Moderate Fund and Balanced Fund from the same manager. This type of strategy makes no sense – the only reason why an advisor would do this is in the hope that at least one of the funds will perform well at any one time. Hope has never been a great investment strategy…

WHAT SHOULD YOU DO?

1. Understand your asset allocation

Ask your advisor to tell you how much of your investment money is allocated to shares, bonds, property and cash. It is important that he or she can give you this information for all your investments together i.e. not per investment. It is a good sign if your advisor can provide this information relatively easily. This is probably the most important factor to determine how well your investments will grow over time and how much money you will lose in a stock market crash.

2. How much are you actually paying?
I recently met another person who has more than R50m invested with one of SA's big private banks. He has been with them for nearly 10 years and has used all the services on offer i.e. a Private Banker, Wealth Manager and offshore fund manager. He was shocked to realise that they have actually been charging him more than 3% per year in fees and he only found this out after threatening to move his money unless they provided the information. There can be no justification for charging any investor more than 3% per year for investments, especially not someone investing more than R50m who should benefit from some economies of scale. Your total costs should be less than 2% per year and this includes advice fee, administration (platform) fee and fund management fee. If you are paying more, it is probably time to make a change.

If you really want to challenge your advisor, ask how much you are paying for your Retirement Annuity provided by an insurance company. It is nearly impossible to get the whole answer. If you contact them directly, the insurance company will usually refer your query to the "actuarial department" where they will tell you that your "management fee" is 1.90% (as an example). Then ask whether this is the total fee i.e. does it include advisor commission? The same actuarial department will then refer you to some other department and so the process continues. From personal experience, I have found that insurance company RA's cost about 3.5% per year, which is outrageous.

3. Do you understand how much you could lose in a crash?
It is a fact of life for investors that you have to take some risks if you want to grow your money faster than the inflation rate. It is impossible to beat inflation unless you have a portion of your money invested in shares and listed property. These two asset classes provide good sources of capital growth but the growth comes in bursts and there will be times when you will lose money. A good advisor should be able to tell you how big the losses will be given the amount invested in shares. You need to be prepared for these losses. After-the-fact discussions about losses with unprepared investors will never go well and usually will result in adverse outcomes for investors.

Understanding these three issues and gauging how well your advisor understands them should help you determine if you are being professionally advised.