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Who Is Truly Managing Your Money?

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WEALTH SOLUTIONS

Who is Truly Managing Your Money?

You care about your money. It may represent your security, freedom, your dreams, or any number of things. Does your financial advisor care about your money in the same way? With all the market uncertainty do you have a solid plan that will guide you through the best and worst of times?

An AllianceBernstein study recently surveyed affluent investors to measure their confidence in achieving their long-term wealth goals. Less than 25 per cent of investors were confident. In sharp contrast, over 90 percent of those with a formal wealth management plan expressed confidence in achieving their wealth goals.

Affluent families are looking for trusted professionals and financial plans they can trust.

Seven key questions answered as to why you need your own portfolio manager.

1. **Is your advisor qualified to manage your portfolio?**
2. **What is the actual cost of managing your investment portfolio?**
3. **What is discretionary trading?**
4. **What is your risk tolerance?**
5. **Do you have an IPS?**
6. **Do you have a realistic financial plan?**
7. **Who should be managing your money?**

Q. 1 Is Your Advisor Qualified to Manage Your Portfolio?

"Janitor by day, advisor by night"- Bruce Morrison

Know your advisor. To make an informed decision in choosing your financial advisor it is important for you to research his or her background and qualifications.

When we talk about qualifications, a key issue is licensing. Licensing in many ways determines what type of investments the advisor is able to make on your behalf.

Within the Financial industry, there are multiple regulatory organizations that are responsible for registrations of Individual Advisors. Only the Investment Industry Regulatory Organization of Canada (IIROC) is responsible for advisors who want to offer clients products ranging from mutual funds and GICs to stocks, bonds and other more complex alternatives.

IIROC sets high quality regulatory and investment industry standards through setting and enforcing rules regarding the proficiency, business and financial conduct of dealer firms and their registered employees.

Applicable provincial securities commissions and provincial insurance councils are also important licensing agencies. Qualified financial advisors must have their licenses registered every year and they have to maintain a required number of continuing education credits in order to keep their licenses.

One of the most significant investment designations for an individual advisor is Certified Investment Manager, CIM, which is one of the requirements to qualify an advisor as a Portfolio Manager. IIROC defines a portfolio manager this way: *a registered representative who has been designated and approved for the purpose of managing the investment portfolio of an investment dealer's clients through discretionary authority granted by the clients.* Only a very small percentage of financial advisors in Canada achieve this designation.

By partnering with a portfolio manager you can put yourself in a position to maximize the opportunities in the money management marketplace and do it cost-effectively.

Q. 2 What is the Actual Cost to Manage your Investment Portfolio?

"For some reason people take their cues from price action rather than value action. Price is what you pay. Value is what you get." –Warren Buffett

Once you have done your due diligence in determining a financial advisor's license qualifications, the next step is to look at the cost of managing your money. With cost you need to look at what kind of investments you are going into, which is dictated by the license. For example is your money being invested in mutual funds, stocks, bonds, GICs or segregated funds?*

Mutual fund fees. There are different levels of fees. One is the Sales Charge. You may choose to pay the front-end sales charge or a deferred sales charge. A front-end sales charge is a fee that is negotiated with and paid to your dealer to a maximum of 5% when you make the purchase of a fund. A Deferred Sales Charge may be payable by you to us depending on when you redeem, switch, reclassify or convert your mutual funds. A regular deferred sales charge exists for seven years. A Low Load sales Charge lasts three years.

Then there's the management fee and added expenses, which is called the MER, Management Expense Ratio. These fees are paid out of the fund itself. Let's say one of your funds earns a gross 10%. If the MER is 2.5 percent, the 2.5 is deducted and you get paid 7.5 percent. What if you earned minus 10%? They still get their 2.5 and now your return is minus 12.5%, because you have to pay them. The MER is disclosed in the prospectus of each mutual fund, and varies among all of the different funds, so please read the prospectus carefully to determine which MERs apply to you.

Transaction Costs. There are two common versions of these transaction costs, either as a percentage of the dollar amount of each trade, or a flat fee per trade.

Something else to keep in mind is that no matter how frequently you trade in your account, whether it is a percentage per trade (eg. 1.5% to buy and sell) or a flat fee per trade (eg. $100.00), these costs can add up quickly if there's a lot of activity in your account.

Fee for service. An alternative to the transaction costs is a fee for service account. In a fee for service account, a monthly fee based on the market value and composition of assets held in the account will be assessed.

As attractive as these types of accounts may seem, most come with conditions where additional fees and expenses may apply, such as purchasing new security issues or if trading levels exceed established thresholds. So while you may not be paying transaction costs per trade, you may end up paying a fee for minimal/no service in order to avoid paying additional fees.

The portfolio management fee. This is a fee based solely on the value of your account. This provides an incentive for the Portfolio Manager to achieve better performance within your accounts. In addition, some portfolio managers may have a performance bonus agreement. In these agreements, the portfolio manager will be paid a percentage of the profits should your account outperform pre-set expectations.

For example, let's say the TSX increased in value by 10% in a period. In that same period your account grew by 15%. If a performance bonus agreement exists, your portfolio manager would receive a fixed percentage of the amount that exceeds the benchmark growth (in this case 5%, 15-10).

The portfolio management fee structure is the only management style that includes discretionary trading, which is described on the next page.

*Insurance products provided through Dundee Insurance Agency Ltd.

Q. 3 What is Discretionary Trading?

"As a portfolio manager, the goal is to be an efficient buyer and seller. Lots of advisors know how to buy, but not many know how to sell"-Bruce Morrison

Discretionary trading is where a qualified advisor has been granted authorization to make decisions regarding the security, price, quantity or timing of orders. It removes the requirement of consulting with the client on each and every trade, before the trade is placed. Portfolio Managers are advisors qualified to conduct trading in client accounts on a discretionary basis.

Let's suppose your advisor feels that XYZ stock is a good value based on its fundamentals and is doing business in a sound sector (macroeconomics). XYZ is also technically cheap in terms of price. Your advisor has 100 clients for whom XYZ is suitable. Traditionally, the advisor has to call each client to get permission to buy. So who gets called first; friends, biggest clients? Out of 100 clients how many are actually contacted before the price moves?

A Portfolio Manager is able to make the decision on your behalf immediately, without the phone call.

The advantage of this is that you will get the buy no matter what. Secondly, when the time comes to sell, the discretionary portfolio manager again has the authority to make the trade immediately. A third advantage is what's called the bulk trade, where everybody gets the same pricing, no favourites.

With discretionary trading, people sometimes fear they are giving up control of their portfolios. Discretionary management is best suited for delegators; not do-it-yourselfers.

Q. 4 Do You Have an IPS Agreement?

"Accountability is one of the essential steps of any good financial plan." –Wesley Watkis, Financial Journalist

We now come to a vitally important factor in determining how your money is managed. To develop a proper plan, every advisor should be producing an Investment Policy Statement.

The letters IPS stand for Investment Policy Statement. It is an agreement that defines the guidelines on how a Portfolio Manager is to manage your account.
For example, if it says you are a conservative investor and never want to hold more than 20% of the portfolio in high risk stock, the portfolio manager can't roll the dice and gamble your portfolio away. The Portfolio Manager is responsible for maintaining your investments within your core allocation, your risk tolerance.
Therefore, before we can invest anything we find out what your true investment objectives are, what your risk tolerance is and then we design a plan and put it in a contract.
It is a commitment to stay within these guidelines while at the same time trying to earn a decent return for you. If the portfolio manager is truly committed to what they say to you, get it in writing. Portfolio managers have a responsibility to stay within guidelines and parameters in terms of investment allocation.

The investor tells us what we're going to do. You're in full control because you have told us what you want.

The IPS outlines and dictates our responsibilities as investment and portfolio managers to manage your investments within those guidelines. It is a partnership.

Too often there are no boundaries and investment choices are determined by the "flavour of the month" or the hot stock tip from the neighbour next door. There need to be clear cut boundaries to stay within the investment strategy.

No one knows exactly what's going to happen in the markets, but an IPS ensures that the rules are in place to execute the plan on a daily basis. We can't hit a home run on every stock we pick and that's not our goal.
Our goal is to hit a single, followed by another single, moving everybody around the bases till they get home. It's a team effort, built on realistic expectations.

Keep in mind; we focus on risk adjusted returns. Consistency versus roller coaster rides. Both approaches get you to the same place, but one can make you feel sick to your stomach and vomit.

So consider developing an IPS with a Portfolio Manager, as it will give you the peace of mind of knowing that it clearly states the guidelines that you are comfortable with investing your money, and using this you will then be in a better position to develop a suitable financial plan for your financial future.

Q. 5 What is Your Risk Tolerance?

A definition of risk tolerance: "The degree of uncertainty an investor can handle in regards to a negative change in the value of his or her portfolio." -investopedia.com

The first step in developing an IPS is determining your risk tolerance and objectives. Generally this is done with the help of a questionnaire which focuses on key questions like how much you have to invest, and how long you have to invest. In other words the time frame of the investment and will you need any of that money while it's being invested. Time horizon is a key to determining your asset mix (the kind of investments you should be in). Someone who is 40 should have a different asset mix, than someone going into retirement.
Sometimes there's quite a disconnect between what type of investor you think you are and what your answers in the questionnaire tell us you are.

To illustrate this point, here are two key investor profile questions.

1. When do you anticipate you will need this money?

A. More than 10 years
B. 5 – 10 years
C. 3 – 4 years
D. 1 – 2 years
E. Less than 1 year

2. Which would you say best describes your investment goals?

A. Aggressive Growth
B. Growth
C. Enhanced Yield
D. Income and Growth
E. Income
F. Security

Let's say you answered D or E to question 1, and A to question 2. These answers say two different things about how you want your money to be managed.
By answering that you need your investment returned to you within the next two years, suggests that you should be conservative with your investments in order to protect what you already have while trying to make some gains.
The answer to the second question that you want aggressive growth would suggest that you are willing to take additional risk; the more risk you expose yourself to, the greater the chance that your initial investment will not be returned to you in such a short time.

Two other important risk tolerance questions are;

1. How would you describe your comfort level should the value of your investments decline in the short term?
2. What level of assets will your family be investing?

By carefully going over your answers on the investor profile questionnaire with you, your portfolio manager helps you understand your comfort level in investments, and discover what your true risk tolerance for investing is. Knowing and understanding this will define the guidelines within the IPS.

Q. 6 Do You Have a Realistic Financial Plan?

"Over 90% of investors with a formal wealth management plan are confident they will achieve their financial goals." –AllianceBernstein Study

To develop a realistic financial plan we will find the experts we need to establish a financial plan that meets your situation and your needs.
Do you have a cottage? Do you have insurance in place? Do you know if you'll have a big tax bill? Do you have a corporation, company or pension plan? We try to find out the best tax strategy for each of our clients based on their family situation and then we look at their estate plans because there needs to be a transition plan.

Key questions you need to look at. Are you going to have enough money when you retire and will you be able to retire the way you want and what do you have to do to get there? What's going to happen to your estate? Who is it going to? What are the tax consequences? What needs to happen when you sell a company when you retire? We look at your lifestyle needs, your goals and plans and what does retirement look like to you.

So it's all about execution and follow-through, making sure the plan is still on line, making sure it's going in the right direction, being proactive in response to the client's ever changing life circumstances. Good financial plans adjust, so it's important to have an advisor who is in step with this by keeping the relationships alive.

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Q. 7 Who Should Truly be Managing Your Money?

"If you truly want to achieve more financial success in the future, you need a partner." –Bruce Morrison

Here is a summary of important points to consider when you are choosing a financial advisor. You want to choose an experienced, highly qualified person to manage your investments.
In terms of cost, you want full disclosure and transparency so you know exactly how much you are paying people to manage your investments.

It is also important to determine the purpose of the trade, which should be discussed with your advisor. For example: it's being made because the price target has been hit; or there may have been a change in management, or there may be a better investment option.

Another key question. Can the person managing your investments trade on a discretionary basis? Whether it's buying or selling you deserve to have your trade made the minute it needs to be done. Whether the advisor has 100 clients or 1000, everybody who owns ABC stock should have it bought and sold at the same time and the same price. That's discretionary trading.

You need a financial advisor who can accurately assess your risk tolerance. This helps determine what type of investments you should be in and it lays the foundation for the vitally important IPS. The Investment Policy Statement is a written statement from your advisor to you outlining the boundaries that you have set for your advisor. Those guidelines clearly state how your investments are to be managed. Without an IPS how can you really know if your advisor is managing your account in a way that will actually achieve your financial goals?

These are the building blocks for a realistic financial plan. You need to know what type of investor you are, the kind of investments you should be in and how much you are paying for the management of your money.
So by aligning your life goals with your risk tolerance and investing objectives, the portfolio manager helps you reach your financial goals, which comes down to succeeding at your financial plan. These plans need to be reviewed on a regular basis to make sure boundaries and benchmarks remain clear.

Everything is covered in the IPS. It is a legal binding contract that says "here is what we do for you," and "here is what you have to pay for." The IPS protects both parties.

A final note. Portfolio managers differ from mass-market or retail investment managers because they manage larger amounts of money for fewer clients. This often results in lower management fees.*

They are amongst the elite people in the field of financial information.

They can provide you with a written Investment Policy Statement clearly outlining your risk tolerances, your objectives, your boundaries which define how your money is managed. Only a portfolio manager has the authority to make discretionary trades on your account, ensuring that you will get your trades when appropriate, and not missed because you missed your advisor's phone call.

If you want a trusted advisor who can execute a plan and provide you with the sound advice you need, call us.

*Portfolio Management Association of Canada

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About The Author

WHO IS REALLY MANAGINGYOUR MONEY?

When you realize you need to get it right and you start taking a close and serious look at who is managing your money, it can be invaluable to understand the core values that govern your advisor's approach to wealth management.

Bruce Morrison's values have been shaped by over 25 years of hands on experience in the financial industry. His diversified career has seen him excel as an investment advisor, a business builder, branch manager, private client group director and portfolio manager. For Bruce, having navigated the best and worst of times in the markets the focus of his work is taking the emotion out of investing.
"I truly care about the success of the clients. I believe if you have a process and you stick to the process, you won't let the emotion of the markets get in the way of good decision-making. In that way you can do a fantastic job for people.
I believe if you spend enough time putting in the foundation properly, the building will get erected properly. That's what wealth management is all about; making sure the foundation is extremely solid"

How solid is your foundation?

Bruce continues to host "The Money Forum" a long-running, weekly, half-hour radio program. This highly respected show takes an insightful approach to wealth management, featuring Bruce in conversation with expert guests, talking about a wide range of financial topics.

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