Learn about how your adviser adds value

Client note

Many investors find it increasingly difficult to invest on their own, particularly as they amass wealth and their finances become more complex. That's when professional financial advice can help. An experienced financial adviser provides customised portfolio management and discipline, which can better position you to reach your long-term investment objectives.

A skilled financial adviser has the training and insight to:

- Understand your goals for investing.
- Help create an investment strategy that can meet your short- and long-term needs.
- Make sense of an array of investment vehicles and determine how they fit into your portfolio.
- Keep you focused on your objectives.
- Monitor your portfolio during all types of markets.

The importance of an investment strategy

A carefully planned investment strategy is a practical way that you and your financial adviser can make sure that you maintain the direction and discipline that you need to reach your investment goals.

The first step in creating an investment strategy is to work with your financial adviser to understand what you want to accomplish with your portfolio. You and your financial adviser will need to determine your investment goals, risk tolerance and time horizon.

Periodically, your adviser will revisit your investment strategy to ensure that your portfolio is on track and to make any necessary adjustments.

Understanding your investment philosophy

With your financial adviser, you'll also define your investment philosophy. Your adviser will help you identify your attitude toward investment risk, asset allocation and diversification, trading and investment costs. Establishing your investment philosophy will help guide the decisions you and your adviser make about your portfolio.

Asset allocation

Asset allocation refers to the mix of your investment dollars among various asset classes, such as cash, bonds and shares. Asset allocation is a critical factor in determining the long-term returns of your portfolio, and it helps you and your adviser determine the appropriate trade-off between risk and return for your needs.

Your financial adviser will consider several factors when developing an asset allocation that's right for you, including:

- **Your investment goals.** Your adviser will need to understand your short and long-term objectives—for example, a home purchase, your children's education, retirement or business financing—to create an allocation that helps you reach your goals.
- **Your risk tolerance.** Do you lose sleep when the markets slide? Or do you shrug off market slides as a normal part of investing? Your financial adviser can help you understand your emotional reactions to the risks of investing and help you create a plan that suits your investment temperament.
- **Your time horizon.** For your adviser to tailor your portfolio to your goals, it's important to define your financial time horizon. A portfolio invested to finance retirement in 20 years would include a different set of investments than a portfolio intended to finance an imminent retirement. Your financial adviser will work closely with you to establish an allocation to meet your needs.
- **Diversification.** Your adviser will generally build your portfolio using a variety of asset classes to achieve a high level of diversification and long-term stability.
- **Your comfort with risk versus return.** The concept of risk/return suggests that low levels of investment risk will result in low returns, while high levels of risk will generate higher returns. Of course, there are no guarantees. Increased risk offers the possibility of higher returns, but it can also lead to bigger losses. Your adviser will help you balance the risk you're willing to accept with the investment returns you need or want.

One risk/reward question your adviser might ask you is whether you want to invest in index or actively managed funds (or ETFs). Active funds tend to have higher expense ratios and tend to be less diversified than index funds. That combination—higher expenses and less diversification—has often contributed to lower returns for actively managed funds, resulting in an unappealing alternative with potentially more risk.[1]

Periodic rebalancing is essential

You and your adviser will decide how often to review your investment plan to make sure it stays on track to meet your short- and long-term investment goals. But remember that no particular asset allocation or mix of funds is guaranteed to meet your investment objectives or provide you with a given level of income, and diversification doesn't ensure a profit or protect against a loss in a declining market.

1 For the gross returns of an actively managed fund to differ from that of an index - a style-matched benchmark, the composition of its portfolio must differ in some way. Often actively managed funds are not as well diversified as the benchmark, a factor that adds risk. In addition, an actively managed fund could significantly outperform its stated benchmark but it might still underperform the benchmark, a possibility referred to as "active manager risk." It's not uncommon for an index fund to fully replicate the composition and volatility of its benchmark.

Minimising taxes and costs

Investment expenses and taxes can significantly erode the value of your portfolio. A low-cost, tax-efficient portfolio can be the foundation for long-term investment success.

The value of tax efficiency

Using tax-efficient strategies is an important way that your financial adviser can add value to your portfolio. Your adviser can choose from a wide array of products—including tax-deferred and tax-efficient investments and annuities—and techniques such as managing capital gains and tax harvesting.

One of the most common ways to control taxes is through asset location. The basic approach involves investing in the right mix of regular non-registered accounts and more tax-efficient solutions to minimise taxes and maximise returns. Your adviser can help develop an asset allocation strategy based on your short- and long-term goals, income and tax bracket.

Costs matter

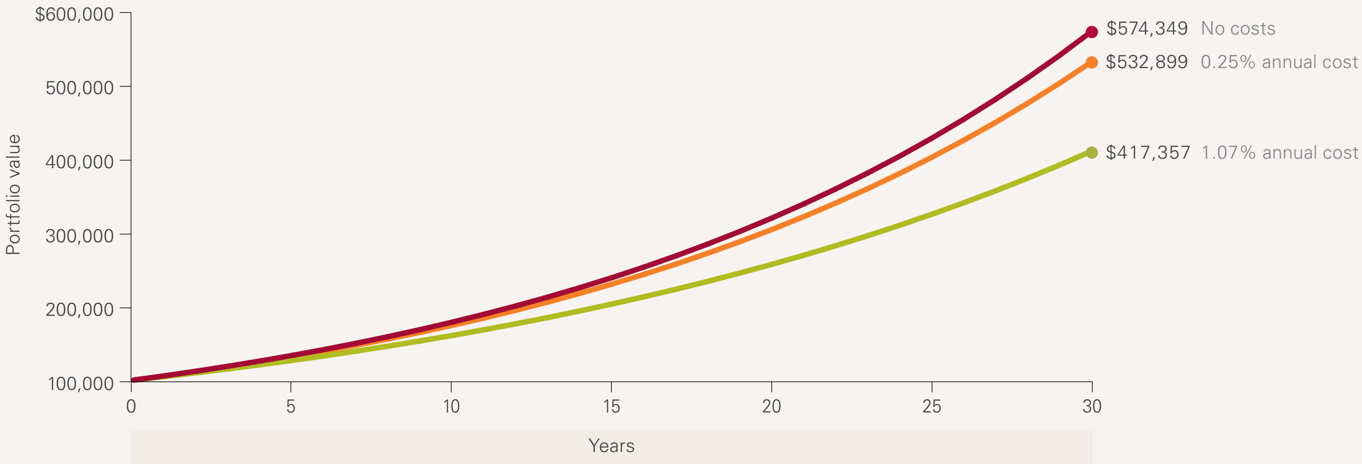
Don't underestimate the importance of investment expenses. Simply stated, costs reduce returns. Figure 1 illustrates how strongly costs can affect long-term portfolio growth. It depicts the impact of expenses over a 30-year horizon in which a hypothetical portfolio with a starting value of $100,000 grows an average of 6% annually. In the low-cost scenario, the investor pays 0.25% of assets every year, whereas in the high-cost scenario, the investor pays 1.07%, or the approximate asset-weighted average expense ratio for Australian equity funds as of 31 December 2015. The potential impact on the portfolio balances over three decades is striking—a difference of above $110,000 (more than the portfolio's $100,000 starting value) between the low-cost and high-cost scenarios.

The advantage of a comprehensive approach

Most investors think of financial advisers as investment counselors whose job is to manage their finances and help them reach their investment goals. A good financial adviser, however, will look beyond your investments to offer guidance on taxes, retirement, estate planning, insurance, education planning and more.

A financial adviser who offers such a comprehensive life-planning approach can add an enormous amount of value by guiding you through the many complicated financial challenges you'll face throughout your life.

Figure 1. The benefits of investing with a low-cost provider



Note: The portfolio balances shown are hypothetical and do not reflect any particular investment. The final account balances do not reflect any taxes or penalties that might be due upon distribution.

Source: Vanguard calculations, using data from Morningstar.

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