

Is there Value in Paying for Financial Advice?

Before answering this important question, we must first understand what financial advice is. A common myth is that financial advice/planning is primarily about choosing investments. This is far from accurate as true financial planning extends far beyond investment selection and includes, but is not limited to, advisor **“best practices”** as outlined below.

- Having an intimate knowledge of the clients;
 - Assets and liabilities
 - Marginal tax rates now and projected future rates
 - Available cash flow
 - Corporate structure(s) and corporate financial statements (for business owners)
 - Personal attitudes and values towards money
- Building a written roadmap(s) for life’s important financials goals like tax efficient retirement income and legacy wishes,
- Building a written investment strategy consistent with your financial roadmap and risk tolerance,
- Planning to reduce taxes now, in the future and in your estate,
- Behavioral guidance - help avoid expensive mistakes through emotionally charged decisions
- A pro-active process for regular reviews and updatesⁱ

What is “Advisor Alpha”?

Is there a way to measure the value of financial advice? The Vanguard Group, which is the world’s 2nd largest money management firm and does not employ financial advisors, has conducted an in-depth study on advisor value which they call **“Advisor Alpha”**. The term **“alpha”** is used to measure the additional value provided for a service above the cost for that service.

The Vanguard research is focused on advisors who provide **“best practices”** service of wealth management and excludes advisors whose main service is choosing investments. Their results for the “average” advisor value added in each category is shown below;

Advisor “best practice”	Average Value Added
Portfolio Construction	1.73%
Wealth Management	0.88%
Behavior Coaching	1.5%
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4.11% = total average value added	

To determine the average **Advisor Alpha**, we subtract an assumed advisors fee of 1% from the average additional value added of 4.11% giving us an annual **Advisor Alpha of 3.11%**.

Advisor “Alpha” and Financial Asset Growth

Another way to measure the value of financial advice can be illustrated by comparing the growth of financial assets of those who receive financial advice and those who don't.

The Value of Advice

Advice has a positive and significant impact on the growth of an individual's financial assets.



4-6 years of advice



7-14 years of advice



15+ years of advice

Source: Econometric Models on the Value of Advice of a Financial Advisor, CIRANO Report

According to this study, financial advice was found to have a positive impact on:ⁱⁱⁱ

- 1) Improving the investment process
- 2) Adding discipline and rationality to investment decisions
- 3) Improving saving rates, portfolio diversification, and tax efficiency
- 4) Significantly increasing investors' confidence that they will retire comfortably

Other Considerations

1. About the research discussed in these reports

- a) This research is somewhat limited; as financial advisors can add value in many ways that are hard to quantify. Some advisors may offer much more added value than the average and others, less. The added value will vary year to year based on your situation. It could be added quickly during market declines or euphoric markets when you may be tempted to abandon a well thought out investment plan. Other times, value may be added much slower and may not be readily obvious on your regular statement.

2. About the value and need for advice as we age

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- a) As we age, it is normal for cognitive skills to decline making it more difficult to manage one's own investments and financial situations.
- b) Households where one person holds primary financial decision-making responsibility will often will result in the surviving household member(s) being vulnerable if they outlive the primary decision-maker.

In both situations, having a trusted advisor can shield seniors and surviving household members from costly omissions and mistakes. These mistakes and omissions can be far reaching and can result in the erosion of decades' worth of wealth creation efforts.

3. **About investment and financial planning being an ongoing process**

- a) Even the best investment and financial plans will ultimately fall flat without a process for regular ongoing reviews and updates. As our desires, needs, and attitudes evolve, and financial markets and tax laws continue to change, so too do your investment strategies. A financial and investment strategy that works well today may not be appropriate next year. To be truly successful, financial planning must continue for a lifetime and is not a onetime event.

Conclusions

Let's return to our original question; is there value in paying for financial advice? The answer is, it depends.

Do you have the time, interest, energy, desire, knowledge, and emotional discipline to carry out the "best practices" of financial advice yourself on an ongoing basis? If the answer is yes, then paying an advisor may not provide sufficient value for you. You may even make a good advisor yourself.

If, however, your answer is no, research strongly suggests that working with an experienced, professional financial advisor who offers comprehensive "best practices" financial planning and not just choosing investments, will likely result in your net financial gain or "**alpha**" far outweighing the fee charged.

ⁱ Pfau, Wade, "The Value of Financial Advice" (2015)

ⁱⁱ Vanguard, "The Added Value of Financial Advisors" (2015)

ⁱⁱⁱ Montmarquette, Claude & Viennot-Briot, Nathalie, "Econometric Models on the Value of Advice of a Financial Advisor" (2012)