Factors In Focus

Redefining Investment Advice

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Investors realize that "advice" from financial services firms and their representatives is usually nothing more than a forecast of some sort about the market, the economy, interest rates, or the best stocks to buy. Of course, the firm or representative is always willing to facilitate the purchase of a product or security that will help them profit from that forecast. Sometimes they'll admit that the forecast could turn out wrong, and if so, they are happy to steer them in another direction with more products and services available for those scenarios as well.

The firm and the representative, or "broker", make money every step of the way as each transaction generates a commission, and often times additional revenue through hidden charges, fees, mark-ups, or sales concessions. And so long as the security sale can just be proven "suitable", brokers are absolved of any responsibility for the outcome.

To the investor's surprise, brokers don't even work for their customers. The broker's first duty is to the firm they are employed by. While there may be a sprinkling of actual advice on occasion, this is incidental to the broker's main business of generating profitable trades and commissions *for their company*.

Investors are "warned" in a round-about way as the fine print on brokerage applications says "our interests may not always be the same as yours", but few ever read the details. So for them, it's ***caveat emptor***.

This is the traditional "Wall Street Model" of investment advice—a never-ending series of empty forecasts and expensive and unprofitable (to the client) products that won't help them achieve their goals except by pure chance.

A *Client*-Centric Approach

The "Wall Street Model" isn't the only option for investors. An entirely separate segment of the financial services industry exists to partner with investors and truly assist them in achieving their long-term goals. Independent, Registered Investment Advisory firms (RIAs) like Servō Wealth Management are set up differently. Governed under the Investment Advisers Act of 1940, RIA firms (and their advisers) are not in the business of selling products for commissions. Instead, our sole function is to provide financial and investment advice on behalf of our clients.

Registered Investment Advisory firms maintain a fiduciary standard of practice, meaning we must always act and serve in our clients' best interests and eliminate (or at least disclose) any potential conflicts we have. Traditional Wall Street firms are exempt from this regulation and these disclosures, and are allowed to get away with their actions by admitting "any advice we provide is incidental to our business as a broker or dealer in the sale of securities". If all investors knew about this distinction, it's hard to image anyone would choose not to work with an RIA firm.

Not All Advisers Are Equal

While there are over 10,000 RIA firms throughout the country, not all are the same. There are five key criteria for how they work with clients that separates the best firms from the rest.

#1—Take A Holistic Approach

Investors are more than just their portfolios. To do the best job helping clients with their long-term financial goals, an adviser must understand how each person and family is unique, and the different "human capital" and non-investment challenges they face (including estate, tax, insurance, and business issues).

All of these considerations should be integrated to provide the best and most complete advice. Where necessary, partnering and consulting with outside experts results in greater overall value and execution, as no professional can be knowledgable about all financial matters.

#2—An Emphasis On Education

The traditional "Wall Street Model" strives to keep their customers in the dark about important issues such as how markets work and how best to capture market returns.

Early on, the most value an adviser can provide to their clients is to help them understand that forecasts about the future don't work, generally cost a lot of money, and are best ignored. By helping transform the investment experience into one based on patience, intellect, and evidence-based financial theory, and away from emotion and short-sightedness, the best advisers enable their clients to stay the course through thick and thin, giving them the highest probability of achieving their goals.

#3—Embrace Broad Market Diversification

Modern capital markets allow investors to easily and efficiently diversify across a range of different asset classes that are appropriate for their goals, time horizon, and tolerance for risk. Today, with just a few low-cost mutual funds, we can attain an ownership stake in more than 10,000 distinct companies spread across over 40 countries as well as thousands of corporate and government bonds. As asset classes behave differently from one another, each plays a different role in a portfolio. The whole is greater than the sum of its parts: investors achieve greater expected returns with lower risk in a diversified portfolio.[1]

The days of needing to select and trade concentrated individual stock and bond portfolios and expose ourselves to their unnecessary risks have passed. The best advisers spend their time focusing on each client's total portfolio to ensure it continues to reflect their personal objectives.

#4—Maintain Discipline

We now have decades worth of academic research that helps us understand the way markets behave and where returns come from, but the short-run is always unpredictable. As such, the big wild card for investors and their outcomes is the amount of discipline they exercise in adhering to their personal investment plan in the face of market or economic adversity. While market returns are usually more than sufficient to achieve financial success, investors who abandon their long-term strategy in response to recent events or predictions about the future may fall short of that target. Helping to maintain discipline is difficult and often the value of doing so is tough to quantify to prospective clients. But successful investors have learned this is the most important service an adviser provides, and can make or break their plan.

#5—Focus on What You Can Control

Many advisers don't believe or admit that the short-term is unpredictable and their job isn't to frequently reposition portfolios in response to perceived future events. Others struggle with the transition away from a "portfolio potpourri" of individual stocks and bonds, alternatives, niche strategies like sector and leveraged or hedged products, or actively managed funds and separate accounts. But none of these approaches adds value, only unnecessary complexity and the increased chance of plan failure. Instead, the best advisers focus their ongoing research and management efforts on capturing asset class returns most efficiently while minimizing costs and taxes.

Not all investment funds are the same in how they target capital markets. Some provide robust and continuous exposure to the sources of expected return with the least prohibitive total costs possible, including fund expense ratios, trading costs, and market impact. Others with admirably low expense ratios seldom update their holdings and incur "style drift". When they eventually do make changes, they are telegraphed to the market well in advance which increases the hidden costs of those updates and more than offsets small differences in expense ratios.

Finally, to the extent that advisers help their clients minimize ongoing capital gain distributions and ordinary income, and develop total portfolio allocations across different accounts with an emphasis on tax efficiency, clients can achieve higher net returns without accepting greater risk, a welcome tradeoff for the client and time well-spent by the adviser.

An Idea Whose Time Has Come

As the financial services industry continues to evolve, this new model for investment advice is proving to be the winning formula. A client-centered approach perfectly aligns the adviser with the investor. Advisers are able to spend their time more efficiently focusing on what matters —how each client is unique in their objectives, structuring a sound investment plan to accomplish those objectives while capturing the entire return of capital markets, and continually promoting discipline. Clients finally receive the unbiased advice they deserve, are more inclined to believe in and stay with their plans, and experience a greater measure of confidence and success.

Servō is proud to stand on the front lines as a pioneer in this effort to redefine investment advice. You too can become a greater advocate for this client-centric approach. If you have friends or family that you think would be interested in this new model and our unique perspective, please don't hesitate to provide us an introduction.

1 *Diversification does not eliminate the risk of market loss.*

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