VALUE

Embrace the possible™

2019 Value of an Adviser Report

Help your clients understand the
value you deliver

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This report quantifies the value an adviser provides throughout a client's investing journey.

The Value of an Adviser formula offers a memorable and repeatable framework for advisers to have that conversation with confidence.

Executive summary

At Russell Investments, we are adviser-centric. We believe in the value of advice and recognise the difference a great adviser can make to their clients' lives. Unlike many fund managers in New Zealand, we do not have a retail financial business and so we will never compete directly with advisers for clients.

We are true partners and are committed to helping Kiwi advisers reach their business goals.

With growing regulatory attention on fees and natural consumer scepticism about value within the financial services sector, it is perhaps no surprise that some financial advisers in New Zealand struggle when discussions turn to fees. This report looks holistically at the real value advisers deliver for their clients—from the knowledge and expertise they bring in building personalised portfolios through to the support they provide when market conditions change. We also acknowledge the range of financial planning services that many advisers offer, such as estate planning, risk planning and wealth management.

In this 2019 report, we have examined the various components of the typical Kiwi adviser's wealth management value proposition and estimated that this amounts to more than 5% value-added per year to their clients. It may be significantly more than that for those clients who would not otherwise have an investment portfolio were it not for their relationship with a financial adviser.

Clearly, every investor is unique and so estimating the true 'value of advice' is a challenging exercise. We make assumptions about investor behaviour and results that may not be applicable to many in New Zealand. But by identifying specific areas in which an adviser can add value and by demonstrating to clients how this value exceeds the fees charged, we believe advisers can improve engagement and satisfaction. This will ultimately help them build stronger and more meaningful relationships with their clients.

For many financial advice businesses, existing clients are their most persuasive advocates, so articulating the tangible benefits of advice is an essential part of running a successful business. By looking at the key components of an adviser's services—annual rebalancing, preventing behavioural mistakes and financial planning—advisers can clearly demonstrate the value they deliver.

Introduction

Fees and trust in financial services are top-of-mind for many. And with the New Zealand sharemarket hitting all-time highs, some Kiwi investors may question the need for financial advice altogether. But modern financial advice is about more than picking a few stocks. It is about developing high quality, personalised plans that help an adviser's clients meet a range of financial goals and objectives. It often includes services that fall outside of the traditional stock picking arena. We recognise that some advisers may find it difficult to articulate their value proposition in the current environment. This report is designed to make that easier for advisers.

The ABCs of adviser value

The adviser has a complex role in co-ordinating a client's wealth management needs. Every client is unique with their own resources, circumstances, goals and outlook on life. Different strategies and implementation approaches may be needed for the accumulation, distribution and transfer of wealth phases in the typical life-cycle of a client. This complexity becomes even more apparent as markets move from times of plenty into a period of potentially lower returns and higher volatility.

This report is designed to quantify not just the technical expertise an adviser provides, but also the emotional support and guidance an adviser offers throughout a client's investing journey.

A B C P

A
Annual rebalancing of investment portfolios

\+

B
Behavioural mistakes individual investors typically make

\+

C
Cost of getting it wrong

\+

P
Planning and and additional financial services

$>$

Is greater than

YOUR FEE

the annual adviser fee you charge clients

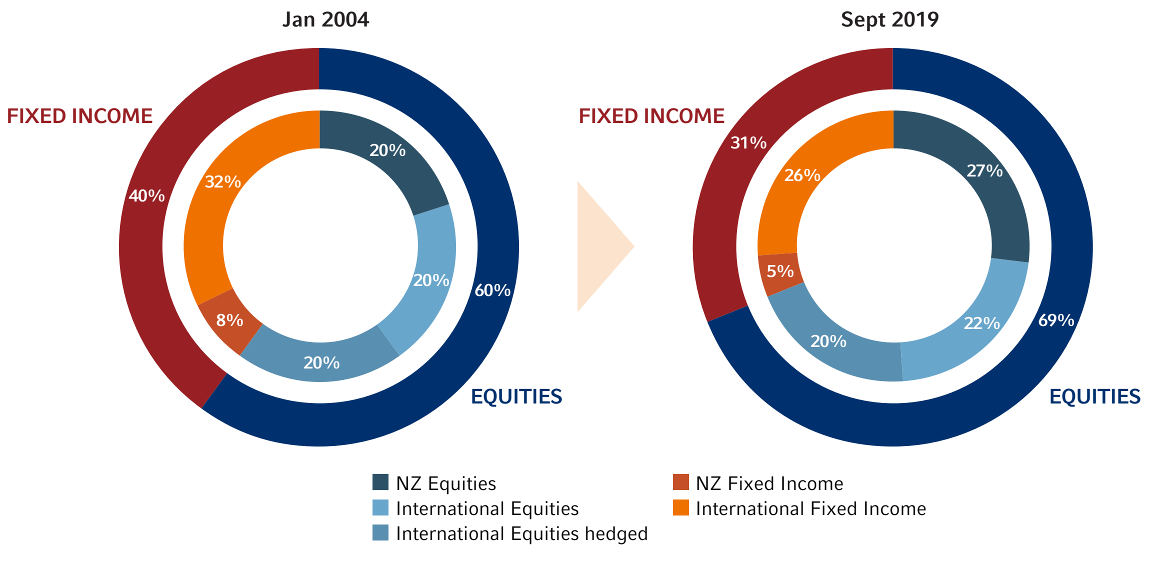
A is for Annual rebalancing = (0.4% p.a.)

When sharemarkets are rising it can be easy to underestimate the importance of disciplined rebalancing.

Avoiding unnecessary risk exposure. Unless advisers clearly communicate the value of rebalancing, we do not expect their clients will appreciate it, particularly during times of booming share`markets. Additionally, without the help of their advisers, clients are more likely to 'buy high' and 'sell low'. They place far too much emphasis on the most recent performance, typically favouring those shares or asset classes that have done well. Or they do not do anything at all. The 'do nothing' approach may work when markets are growing strongly, but portfolios that have not been rebalanced regularly may introduce significant and unintended risks. As this chart demonstrates, a hypothetical 60/40 balanced portfolio launched in 2004 looks very different today, with an asset allocation more heavily weighted to growth assets and significantly more of the portfolio in New Zealand assets than at inception. As a result, this portfolio mix may no longer be appropriate for the investor and it may expose them to significant unintended risks.

When balanced becomes growth

The potential result of an un-rebalanced portfolio



The drift was most pronounced among NZ assets and fixed income allocations

Total NZ assets ↑ **8%**

Fixed income allocation ↓ **9%**

Source: Morningstar Direct, 1 Jan 2004 – 30 September 2019. Hypothetical 60/40 portfolio launched on 1 Jan 2004 held through to 30 Sep2019. We have used the following indices: S&P/NZX 50 TR (New Zealand shares), MSCI ACWI NR (global shares), Barclays Bloomberg Global Aggregate Bond NZD – HTR (Global fixed interest), Barclays Bloomberg Global Aggregate New Zealand TR (NZ fixed interest) and NZ 90 Day Treasury Bills Issue Rate (cash). Share dividends and fixed interest coupons assumed to be reinvested. For illustrative purposes only. Past performance is no guarantee of future results.

Through ongoing communication on the importance of rebalancing and regular check-ins to ensure the suitability of their investment portfolios, advisers play a key role in increasing the probability of good investment outcomes for their clients.

Knowing when and why to rebalance is key. This comes down to advisers having a thorough understanding of their respective client's goals and risk tolerance as well as the implicit and explicit costs involved. The examples shown, illustrate the value that a disciplined rebalancing approach can add both in terms of risk reduction and return enhancement.

Additional returns. Since the beginning of 2004, a regular rebalancing approach would have added approximately 0.4% per annum in additional returns. It would also have lowered the volatility of the portfolio, by about 1%. Perhaps most importantly, the portfolio would be over-exposed to New Zealand and/or growth assets, relative to plan. In the event of an equity market downturn in New Zealand, the rebalanced portfolio would perform better than the unbalanced portfolio.

Hypothetical rebalancing comparison of $1 million

January 2004 – September 2019

		BUY AND HOLD	ANNUAL REBALANCING
0.4% =	**ANNUALISED RETURN %**	**7.5%**	**7.9%**
	Standard deviation %	8.3%	7.3%
	Ending value $	$3.15 million	$3.29 million

Reduction in portfolio volatility **1%**

While 0.4% may not sound like much, compounded over a multi-year period it can quickly add up. In the hypothetical example above, it's a $178,000 difference.

Do you share with your client a written statement on:

- The benefits of a systematic rebalancing policy
- What your strategic rebalancing policy is
- How frequently you rebalance their portfolios
- Your approach to strategic rebalancing policy during periods of market volatility

B is for Behavioural mistakes = 1.9%

Behavioural finance is the academic body of work that recognises the difference between what investors *should* do and what they *actually* do. This is where traditional finance and economics meet psychology. In the context of investing, this often manifests itself in how investors respond to market events, often times over-reacting to short-term news items instead of focusing on any potential implications for the long-term investment goals. In practice, we often see investors selling *after* periods of market volatility, which can ultimately *reduce* returns and *undermine* objectives.

One of the key beliefs of behavioural finance and economics is that changing bad investor behaviour begins with awareness. Think about how tracking your daily number of steps with a Fitbit can increase the number of steps you walk each day. The power of the Fitbit is the awareness it generates. For an adviser's clients, behavioural change begins with personal awareness of their investing behaviour and of the investment biases that may be causing their mistakes. Once clients are aware of these biases, the adviser can be that accountability partner to help them stay on course.

This could add as much as 1.9% per annum of additional return to an investor's portfolio.

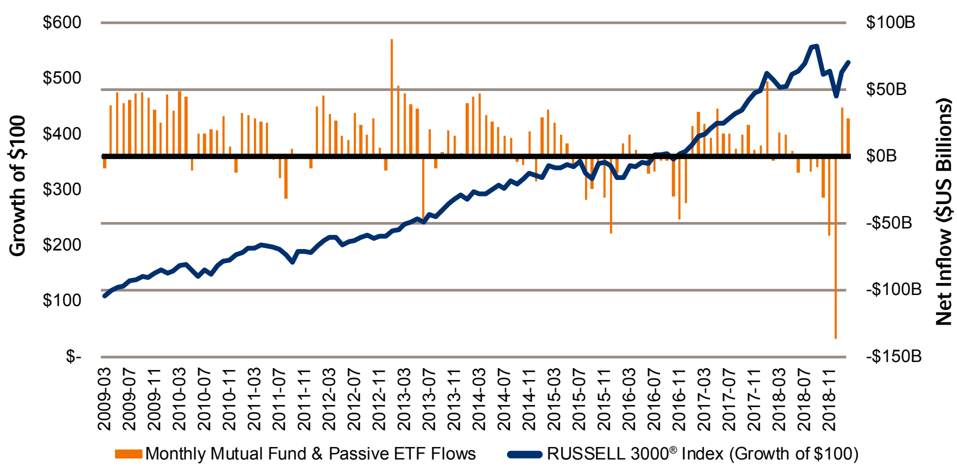
Investors look for patterns in the stock market

Based on our own US analysis[1], the average equity investor's[2] inclination to chase past performance would have meant they underperformed the Russell 3000® Index over time.

To estimate the average investor return, we have examined US equity fund flow data. From December 2007 to December 2018, investors withdrew more money from U.S. stock mutual funds than they put in. All the while, $100 invested in the Russell 3000® Index more than doubled in value. Those that chose to stay in cash during that period missed a cumulative return of more than 200%, based on the Russell 3000® Index. Note, other organisations have also attempted to illustrate how bad timing can undermine otherwise good investment selections and impact investor returns over time. Morningstar, in its annual paper, *Mind the Gap*, estimates that the 'average' mutual fund investor in the US lost about 0.5% per annum to timing over a period of 10 years. Similarly, behavioural finance experts have highlighted the tendency of investors to make investing decisions that ultimately end up costing money due to inherent biases.

Investors don't always do what they should.
Recent proof of a 'buy high and sell low' outcome

U.S. open ended mutual fund and passive ETF flows vs market flows



Data shown is historical and not an indicator of future results.

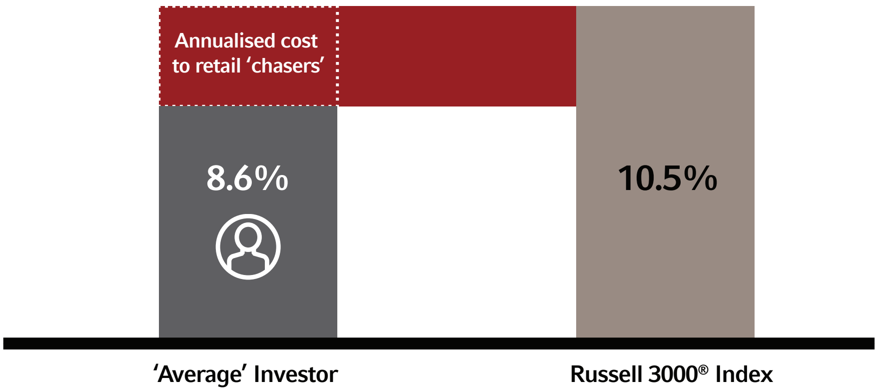
Sources: Monthly mutual fund, passive ETF flows and Russell 3000® Index, Morningstar, Direct.

Data as of 28 February, 2019. Index performance is not indicative of the performance of any specific investment. Indexes are not managed and may not be invested in directly.

The high cost of investor behaviour

No one likes to consider themselves an average investor. But statistically, the average investor's inclination to chase past performance cost them 1.9% annually in the 34-year period from 1984–2018. By working with an adviser, investors can become significantly greater than average. We believe an adviser's ability to help clients stick to their long-term financial plan and skirt irrational, emotional decisions adds this value. It is perhaps *the* key reason why we are such strong proponents of financial advice.

The high cost of investor behaviour
1984 - 2018



Source: "Average" Investor – Russell Investment Group, Thomson Reuters DataStream. Return was calculated by deriving the internal rate of return (IRR) based on ICI monthly fund flow data which was compared to the rate of return if invested in the Russell 3000® Index and held without alteration from 1 January, 1984 to 31 December, 2018. This seeks to illustrate how regularly increasing or decreasing equity exposure based on the current market trends can sacrifice even market-like returns. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.

Manage the conversation

Using behavioural finance to help investors manage their human biases.

Loss aversion	Overconfidence	Herding	Familiarity	Mental accounting
We tend to prefer avoiding losses than acquiring equivalent gains.	We tend to over-estimate or exaggerate our ability to successfully perform tasks.	We tend to mimic the actions of the larger group.	We tend to prefer what is familiar or well-known.	We tend to attach different values to money based on its source or location.

can lead to...

Sell winners too early, hold onto losers too long	Trade too often	Buy high, sell low	Home country bias	Naïve diversification

can be managed...

Illustrate the connection between their investments and long-term goals	Listen and provide perspective	Focus on long-term goals and emphasise a disciplined process	Diversify and cast a wider net for investment opportunities	Money is fungible. Focus on total wealth allocation

We believe advisers can play a critical role in helping investors avoid common behavioural mistakes and may potentially help their clients achieve better portfolio returns than those investors making decisions without professional guidance.

C is for Cost of getting it wrong = 2.9% p.a.

Investing without professional advice can be viewed as an effective way to lower the costs of investing, but this can be a short-sighted and ultimately costly view. For instance, the investor may not set an appropriate investment strategy for their needs, they may lack the skills or time to filter through the many investment options available or they may be tempted to chase performance and over-react to market events. The costs of getting an investment strategy wrong can be vast. One needs only to look at the issues surrounding finance companies in New Zealand during the Global Financial Crisis, which resulted in many Kiwi investors losing large amounts of their net worth (when they thought they were invested in low risk, 'safe' investments). Less dramatic, but still potentially detrimental to the long-term well-being of investors, is the impact of holding too much in low risk, defensive assets, like cash.

Research[3] from Deloitte shows that investors often experience a disconnect between their risk profiles and their return expectations. The study into the attitudes and habits of Australian investors found younger investors were, surprisingly, more risk-averse than their older counterparts. Some 81% of investors under 35 said they were seeking guaranteed or stable returns, compared to 41% of those aged over 55. In addition, 21% of the most risk-averse investors expected returns over 10%.

The role of an adviser in helping clients to determine the most appropriate investment strategy to meet their objectives should not be underestimated. Whether the client's goal is to achieve long-term growth or preserve capital, developing an appropriate investment strategy based on individual risk tolerance, time horizon and investment goals is all important.

To illustrate the impact of having an inappropriate asset allocation, below, we look at the results generated by two of our KiwiSaver funds, the Aon KiwiSaver Russell Lifepoints Conservative Fund and the Aon KiwiSaver Russell Lifepoints Growth Fund. The two funds have a growth/defensive split of 20/80 and 75/25 respectively. While both funds have delivered strong returns over this period, the Growth option has delivered almost 3% more than the Conservative option on an annualised basis net of fees. In dollar terms, this would equate to an extra $63,000 per $100,000 invested over that time period. Clearly any analysis of this sort is time dependent, but this example does highlight the potential scale of the 'mistake' of investing too conservatively.

ALLOCATION	AVERAGE RETURN – 10 YEAR	END VALUE – $100,000 INVESTED
20/80 Aon KiwiSaver Russell Lifepoints Conservative Portfolio	7.5%	$206,503
75/25 Aon KiwiSaver Russell Lifepoints Growth Portfolio	10.4%	$269,722

Source: Morningstar Direct, 1 November 2009 through to 31 October 2019

In addition to developing appropriate asset allocations for their clients, many professional advisers also have the capability to build globally diversified multi-asset portfolios, typically using a combination of directly held securities and managed funds.

Advisers also provide important access to funds and strategies a client may not be aware of or able to access themselves. These include the right active strategies perhaps, complemented with passive strategies like ETFs to keep portfolio costs in check, all while ensuring market opportunities are not being missed.

Portfolio construction and implementation are just part of an adviser's value-add. Advisers continue to monitor the strategy set for their client and ensure all aspects of their personal finances are considered, helping the client to stay on track to achieving their financial goals.

What is clear from our analysis is that financial advisers have the potential to add significant additional value to an investor's portfolio over the long-term by helping clients to work through their values, preferences and motivations from the outset. For investors who elect to proceed without advice, there can be a big price to pay for holding an inappropriate portfolio.

P is for Planning = (variable % p.a.)

Making the complex simple. It is what we strive for on a regular basis. Think about your daily life. Do you pay a premium for simplifying things? Think Amazon, Netflix and Spotify, to name a few. How much would you pay to free up more time to take a vacation, focus on family or better yet, knock off those lingering home improvement projects that never seem to end?

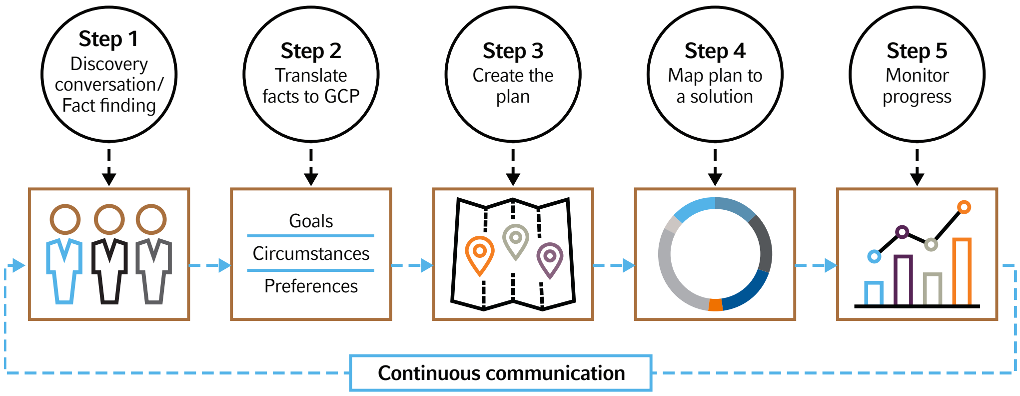
Investors are no different. They are routinely looking for advisers to simplify the complexities inherent in their lives. Many are short on time and lack trust in financial service providers. It is important to build a relationship so they trust in your advice, guidance and wisdom in helping them understand complex investment issues. But be aware of going through the motions. When a financial plan feels like a box-ticking exercise, it can be viewed as a commodity.

Most investors have never taken basic classes in school to learn about money management, let alone had formal training. There is great value in teaching investors how to make the complexities of financial planning, goal-based advice and multi-asset investing strategies simple enough that they will actually want to be a part of helping you help them. In turn, this can create trust, simplicity, candor and confidence in the value advisors deliver.

Are your clients aware of your value? Don't minimise it or give it away!

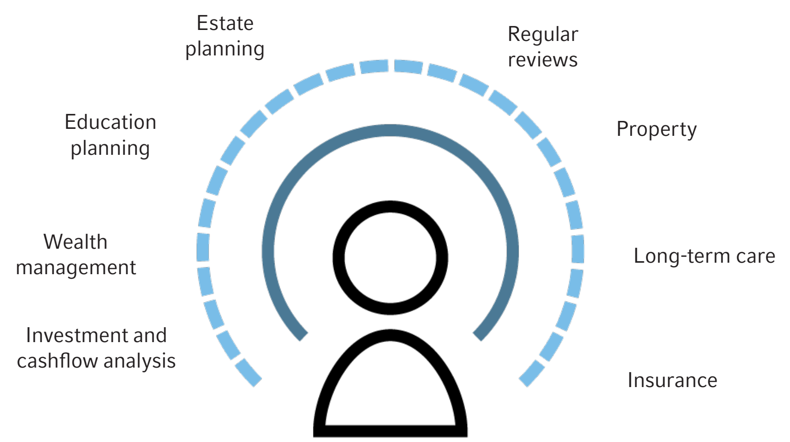
Delivering true wealth management begins with a deep discovery conversation. It is then followed by translating what is heard into goals, circumstances and preferences. The framework is wrapped in a cycle of continuous communication.

Elevate your value: Delivering true wealth management is incredibly valuable



Let's take a closer look at the value of the services an adviser and their staff offer. Advice businesses often underestimate the value of these services—insurance needs, estate planning and cashflow management—which can quickly consume 20, 50 or 100 hours each year.

Planning is complex and varied



Map your commitment and engagement to clients

One of the biggest challenges an adviser faces is to help clients stay focused and on course. A solution to this problem is to provide them with a Client Engagement Roadmap, which positions the adviser as the co-ordinator of their client's multi-faceted financial affairs. This also provides an opportunity to help the client articulate and document their goals and objectives.

The Client Engagement Roadmap then becomes the adviser's client communication plan. It can help to position materials and information, to provide a consistent value-add experience and to highlight the benefits of additional services.

Here we provide an example of what it could look like:

Making a commitment to your clients and, in return, having some expecations from clients, too.

WHAT TO EXPECT FROM THE FINANCIAL ADVISER	WHAT THE FINANCIAL ADVISER NEEDS FROM THE CLIENT
• Transparency into our partnership process, values and priorities	• Openness about your current situation, goals, circumstances, preferences, asset location, and other relevant wealth management information
• Comprehensive financial planning process— creating, monitoring, and updating your custom financial plan	• Proactive, two-way communication as your situation changes
• Regular, ongoing, and proactive interactions with our team to help guide you through the emotions that markets, and investing, may trigger	• At least two face-to-face updates/meetings per year
• On-going asset allocation, investment selection, customised portfolio design & construction • Proactive rebalancing of portfolios	• Feedback on our client events and educational workshops throughout the year
• Tax-smart planning and tax-managed investing	• Annual tax review of your tax return
• Help you build a team of experts to meet all your wealth management needs (tax team, trust and estate lawyer, insurance, banking, business succession, etc)	• Introductions to individuals in your professional and personal networks for whom you believe we can add value

Example client engagement roadmap

Frame conversations to your client's life and goals to help them see their whole financial picture.

January – March
Scheduled activities

- Data gathering
- Financial goals
- Risk tolerance
- Long-range plan

April – June
Scheduled activities

- Goals review
- Roadmap review
- Investment implementation
- Life insurance
- Estate plans updated

July – September
Scheduled activities

- Goals review
- Roadmap review
- Investment review
- Insurance implementation
- Estate plans completed

October – December
Scheduled activities

- Review existing plans
- Roadmap review
- Investment review
- Estate planning
- Client satisfaction review

January – March
Scheduled activities

- Goals and situation review
- Roadmap review
- Investment review
- Education planning

April – June
Scheduled activities

- Goals and situation review
- Roadmap review
- Investment review
- Insurance review

July – September
Scheduled activities

- Goals and situation review
- Roadmap review
- Investment review
- Insurance
- Education: Asset allocation

October – December
Scheduled activities

- Goals and situation review
- Roadmap review
- Investment review
- Family meeting
- Education: Asset allocation

The bottom line

Advisers charge for their services. The focus on fees is a daily conversation in our industry and the regulatory environment continues to evolve with emphasis on transparency, simplicity and value for money. An adviser's clients hears this conversation. But do they also hear about the value of services provided by the financial adviser?

We believe adviser value far surpasses the typical amount charged in fees. We think an adviser's clients should also feel this way. The Value of Advice is meant to help advisers frame the discussion when talking to clients and prospects about the value that they bring to the lives of people they work with. We estimated that the value of a New Zealand adviser in 2019 is:

5% p.a. or more

This value is a meaningful differentiator in a time of regulatory scrutiny and challenging market environment.

Remember, an adviser's clients are their most persuasive advocates, so helping them to understand the value you deliver is essential. This formula offers a memorable and repeatable framework for advisers to have that conversation with confidence:

A	**Annual** rebalancing of investment portfolios	**0.4%**	
+		+	
B	**Behavioural** mistakes individual investors typically make	**1.9%**	
+		+	= **5.2% p.a.** total 2019 value of an adviser
C	**Cost** of getting it wrong	**2.9%**	
+		+	
P	**Planning** and additional financial services	**Variable**	

Let's rise to the call of providing value to investors.

At Russell Investments, we believe in the importance of advisers. We see the advantages you create for your clients. We know the commitment you bring to your relationships. This annual report quantifies that dedication and the resulting benefit. It is one small part of our work in powering adviser success.

Russell Investments has been producing the Value of an Adviser report in the US since 2013 and in Australia since 2018. This marks the first Value of an Adviser report in New Zealand. Over the past 20 years, we've worked with top advisers around the world including the US, Canada, the UK, Australia and New Zealand. The study is based on our 20 years of experience coaching advisers to make their practices more sustainable and to help build deeper relationships with their clients.

For more information:

Contact Russell Investments on **09 357 6633** or visit **russellinvestments.co.nz**

IMPORTANT INFORMATION AND DISCLOSURES

1 As background, Russell Investments has been producing the Value of an Adviser Report in the US since 2013. Over the past 20 years, we've worked with top advisers around the world including the US, Canada, UK and Australia. The study is based on our 20 years of experience coaching advisers to make their practices more sustainable and to help build deeper relationships with their clients. Over time, the study has evolved to reflect the changes in the industry, new competitive forces such as robo-advice and the capital market environment.

We make reference to the study in this report and discuss some of the key assumptions it makes.

2 "Average" US equity investor is based on general cash-flow trends as measured by the Investment Company Institute (ICI) compared to the market's overall performance. US mutual fund data was used, as robust global or Australian historical data is not currently available.

3 Deloitte, Access Economics ASX Investor Study 2017.

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