Pies Are for Dessert: What Clients Really Need Is a Plan

A pie chart may look impressive. But what's more impressive is an advisor's ability to be effective in meeting clients' retirement income goals. • David Stryzewski

After your clients reach age 50, they need more than a pie chart. They need a retirement plan.

I meet with many retirees and preretirees who tell me they have been "working with a retirement planning firm for years." Yet when we dig into what they actually have, often there is not much more than a diversified pie chart of stocks, bonds and mutual funds.

What's astonishing to me is that many of the big Wall Street firms that are considered by most to be trusted names in finance have been hanging their shingles out as "retirement planning firms." However, we find that very few of these firms have done much to advise their clients on issues such as maximizing their Social Security benefits or efficiently coordinating withdrawal strategies that will help clients minimize the impact of taxes on their retirement income streams.

In the face of lackluster advice and the inability of many money managers to beat their benchmarks over time, wouldn't you agree that an investor nearing retirement should question whether they're really receiving valuable advice and whether they truly need to pay someone to help them? This thinking is the reason why we've seen such a dramatic migration away from the traditional advisor/client relationships to the passive, low-cost indexing platforms that Vanguard and many 401(k) platforms have made available.

What I find unfortunate is that many investors have made up their minds to have a "do-it-yourself" retirement with advice through an 800 number. This approach doesn't give retirement investors the opportunity to truly evaluate the strategic long-term and tactical short-term decisions that they should be making.

As you know, someone who is in the accumulation or savings phase of their life has completely different needs than someone who is entering the distribution or spending phase. In retirement, the rules change. Our clients' paychecks stop coming in, and they become dependent on funding their retirement through various savings accounts and defined benefits programs such as Social Security. These folks now need to focus on the preservation and distribution of their assets, as opposed to accumulating them and seeing how they have performed over the past 12 months.

The Value Advisors Provide

I want to summarize a few studies that Morningstar and Vanguard have compiled independently to identify whether there really is a quantifiable value that an advisor can provide beyond a good pie chart. There are many things that we cannot control, such as what the markets will do on a year-over-year basis. But there are plenty of things that we can do through strategic coordination that will help us identify efficiencies and inefficiencies in funding our clients' quality of life, which can make a considerable difference.

Each investor has different goals that change how they would describe a "good financial decision." But, for the sake of this discussion, let's say that it's not the highest potential return. Instead, the definition of a good financial decision depends on the effectiveness of meeting financial goals. For most clients, this refers to their quality of life in retirement.

These third-party, independent sources have shed the light of math and science on what really is the true value of an advisory relationship and what retirees look for in their relationship with an advisor.

Vanguard

Vanguard conducted a study, "Putting a Value on Your Value," that showed the potential impact that a financial advisor's knowledge and experience can have on the growth of clients' retirement accounts.

The study considered three best practices that investors can use when controlling their accounts. These best practices are not necessarily geared toward getting the highest return for all investments. Instead, they accounted for several other factors, such as reducing tax liability and investment or transaction costs and managing risks. The study found that a retirement plan, if properly managed by an advisor, can produce as much as a 3 percent net benefit beyond a plan managed by a do-it-yourself (DIY) investor.

The advisors were able to find these extra growth opportunities by focusing on low-cost investments — those with low expenses. Advisors also were able to grow a client's account by choosing appropriate accounts for tax reduction, by selecting a wide variety of investments and by focusing on total return as opposed to increased income. In addition, the advisors were able to coordinate an account withdrawal strategy, reallocate funds for the best possible scenario for tax/income purposes, and encourage their clients to hold steady to the investment plan even when things appeared to be less than desired.

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Morningstar

In their study, "Alpha, Beta and Now ... Gamma," the folks at Morningstar Investment Management compared the results of investors who receive professional retirement advice with the results of DIY investors — refered to in the study as "naïve investors."

Morningstar researchers took five different issues related to making good financial decisions and explained how naïve investors typically react to each issue, as opposed to the better outcome that a financial advisor could have inspired.

The issues discussed in the study included 1) how to allocate the client's total assets, 2) decisions on income planning, 3) deciding which accounts and how many products to use in retirement planning, 4) how to leverage tax advantages through allocation and withdrawal strategies, and 5) considering expected expenses during retirement. The Morningstar study concluded that using the methods suggested or recommended by financial advisors could boost clients' retirement accounts by as much as 31 percent — or 10 years of additional income.

Many retirees today are finding out that the No. 1 expense they will have in retirement is taxes. This is because most people have saved money in large 401(k) and individual retirement accounts, and have very few Roth or after-tax dollars.

Many families today looking to retire on annual income between $50,000 to $100,000 are typically unaware of the significant things they can do to improve their ability to fund their quality of life. The single easiest improvement that an advisor can make is by evaluating and creating a distribution strategy designed to maximize the clients' Social Security benefits over their expected lifetime. We regularly see this add anywhere from $50,000 to $200,000 in additional benefits over a lifetime.

In addition to the increased monthly benefit this strategy can provide, the fact that these Social Security dollars have tax-preferential treatment means they also will provide tens of thousands of dollars in additional tax savings over a lifetime because they now represent a larger portion of funding a quality of life. The secret to earning more from Social Security is not when you file, but rather how you file, in order to create the largest net income after taxes.

Of course, these studies are limited in the extent of value that can be measured definitively. Financial advisors can add nonmonetary value in all sorts of ways. These ways include lessening the risk of poor financial decisions caused by declining cognitive ability and protecting and supporting family members who are not as financially savvy but may be left in charge, as well as helping coordinate estate matters, Medicare and other health care decisions as clients age.

Your clients most likely want to spend more time with their families and doing the things they enjoy, as opposed to tracking allocations and staying on top of tax laws. As an advisor, you need to show them that if they pay you 1 percent and they receive a difference of 4 percent, they will have netted 3 percent and will be a lot better off for it. Basically, they can't afford not to pay you the 1 percent if you really can bring them all this value.

Don't let your clients be confused about their finances as they enter retirement. I tend to believe the coordination of all these elements is something that gives people the ability to sleep at night, because they know they have a plan that takes into account the risk management appropriate to their tummy test. Everything advisors do can be quantified so that clients know they are still on track. As an advisor, you have the opportunity to show your clients your true value — by creating an actual retirement plan for them and helping them stick to the plan throughout their golden years.

Again, no one knows what the market will do, so advisors must focus on the areas that matter and those they have the ability to control. Most advisory firms focus on offering a pie chart that worked fine while their clients were accumulating assets. But when it comes to retirement, you need to provide more than a pie chart. You need to be producing, evaluating and adjusting a real plan. AN

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Source: *Alpha, Beta and Now ... Gamma,* Morningstar

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