 By Erik Ford

SHOULD YOU USE AN *Advisor?*

As a forewarning to readers, this article will be self-serving to professionals in my industry. I write that partially tongue-in-cheek, but clearly we would not do what we do if financial advisors did not believe we add value.The research and conclusions primarily referenced in this article come from an analysis conducted by Vanguard Research first conceptualized in 2001 and updated subsequently, most recently updated in 2019. The impartiality of this study is supported by the fact that Vanguard supports investing through financial advisors as well as individual investors doing things on their own.

The conclusion of the Vanguard work, that working with an advisor can add measurable value to an investor's portfolio over their lifetime, does not mean it will occur with certainty. We all come to realize very few things are certain in life. However, working with an effective and skilled advisor in a trusting partnership effort may improve your odds of success.

The proposition by Vanguard divides the potential benefits on portfolio management into four categories plus two that overlap with the planning component of a relationship. The first of these is **asset allocation.** While this sounds simple enough, it can be much more difficult to implement. There are studies that have concluded that the proper asset allocation rather than security selection may be the largest contributor to investment success. Aligning your asset allocation with your ability to emotionally and financially take risks and your financial goals sets up everything else.

Once your allocation is determined, an allocation that is consistent with your willingness to take risk and achieving your goals, are you implementing this allocation in a **cost-effective** manner? These decisions are those that relate to the cost of the investments and whether it is beneficial to use a relatively more expensive active manager or a lower cost passive strategy (see my article from the July issue for active/passive discussion). There are several factors that go into these decisions and the detailed knowledge as well as the macro view of an advisor can be valuable in making these decisions.

Once the proper allocation is determined and implemented in a cost-effective manner, **rebalancing** is an important part of the ongoing strategy that the individual investor frequently neglects, even with the best intentions. A key point of a diversified portfolio is to have assets that are not expected to correlate (i.e. move together). This may result in portfolio balances deviating over time away from your target allocation. Rebalancing back to the target is a critical part of maintaining a portfolio's risk profile and long-term return. Good advisors do this, many individuals neglect this important activity.

The fourth portfolio management component is **asset location**. This refers to the division of assets into taxable versus tax-advantaged accounts (e.g. 401k, IRA). Why is this important? When or whether you pay taxes on your investments is important to the long-term value of your portfolio. How income-generating assets versus growth-oriented assets are divided between taxable and tax-advantaged accounts. Once you enter a portfolio liquidation period (retirement), the withdrawal schedule for various types of assets and the relative tax treatment is a valuable consideration in portfolio construction, account structure and financial planning.

There are two areas where portfolio construction and financial planning overlap. The first is **investor behavior**. Industry-accepted studies show that individual investors working on their own frequently make emotional decisions that are eventually self-defeating. Selling out of investments when the market is down (panic) or buying near a top (euphoria) may be discouraged by a thoughtful advisor, benefiting both your investments and plan success.

The other overlapping factor involved in reaching your goals is the **withdrawal strategy**. Eventually, the plan is to pull money out of your portfolio in retirement. Doing this strategically with tax considerations, realizing gains and losses, etc., can certainly add value over the life of your withdrawal period.

If an individual investor already considers and addresses the above issues, great. Chances are they are not, and the follow-on question is how effectively they may be addressing them if they do. A good advisor spends a great deal of time on the intake and analysis of information and data. The advisor can leverage this investment in time across their clients, giving each client the full benefit of this investment in time, training and experience. The point of this piece is to only raise some considerations regarding working with an advisor. With technology today and the availability of information, there is certainly the ability for the individual investor to completely manage their own investments. However, the question is whether doing so is the best use of their time and if through better approaches to the above issues and more professional planning results may be improved.

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