Your Clients Need More of Your Help!

I would like to follow up last month's article where I asked, "Do you think like an adviser or do you think like a client?" Last month I examined the fundamental question that many clients are anxious about: "Will I have enough money to live on?" I probably annoyed many readers by suggesting that advisers tend to answer the question in terms of a lump sum whereas most clients think in terms of their retirement income.

This month I would like to continue the theme and examine the question of "risk". Risk is a subject that is well understood by advisers but they view it through a lens that is different to the client. I have reviewed a number of risk profiling questionnaires and, as expected, they all follow a similar adviser-centric pattern. The majority of questions are concerned with risks related to capital. ie The volatility of the asset values.

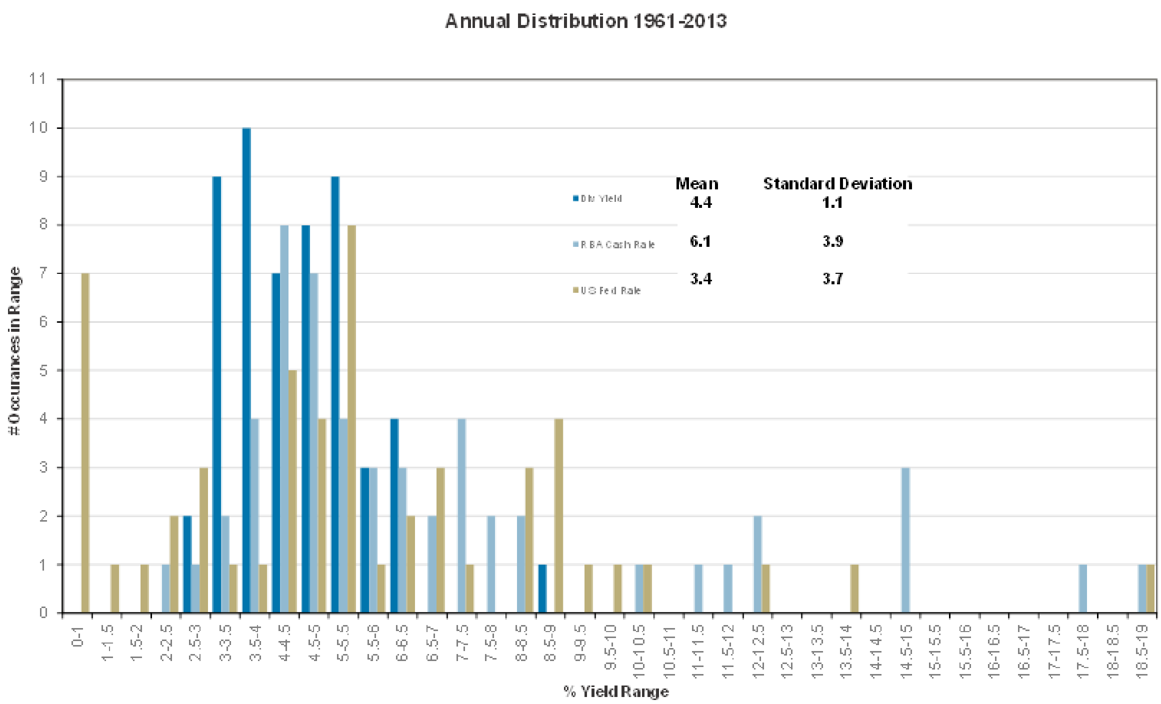
This is not surprising and asset volatility is definitely a significant risk. It is also very familiar to advisers who charge fees based on % of FUM as market volatility directly impacts these advisers' revenue. (This is yet another adverse manifestation of FUM-based fees but I won't climb on that hobby horse today).

As I argued last month, many clients in the retirement income phase of life are more worried about a fall in their income level than a fall in their asset value. So where is the understanding of the clients' attitude to this important risk? I suggest that it is disturbingly absent from the risk profile tools. Worse, the language adopted by advisers and their risk profile tools can be misleading. Let me illustrate…

Let's think about cash investments, say in a cash management account with a reputable institution. Most risk profile documents would classify this as a "low risk/low return" investment class. Advisers use language like "de-risking" or "safe-housing" in periods of market volatility to support recommendations to switch in to cash. Does that make sense to you? Of course.

Well, it wouldn't make sense to me if I retired in 2004 when cash rates were around 5.25% and now they have slumped to 2.50%*. If I was a minimal risk kind of guy relying on income from $1m in cash, my annual income has been cut from $52,500 to $25,000. At what point would you have explained that type of risk to me?
(*Source: RBA Statistical Tables – Overnight Cash Rate)

Many readers would probably suggest that this has been an unusual period so I checked with a far more knowledgeable colleague. He has produced a comparison of the volatility of cash rates in Australia and the USA compared with the volatility of Australian dividend yields:



(Source: RBA, Bloomberg, AMP Capital)

How many clients of financial advisers would be aware that, in terms of income, cash has been three times as volatile as equities? What is your role in leading and educating them?

Many readers would also probably respond with their commitment to balanced asset allocation and diversification. Great – but what is the message that your clients are receiving from you about the risks associated with each asset class? Let me reiterate my plea from last month. It is critical that advisers appreciate what is really important to each of their clients. That is best achieved by way of quality conversations not risk profile questionnaires.

These are the best of times for financial advisers to understand the way their clients think about retirement incomes and to better communicate the full range of risks that will need to be managed.