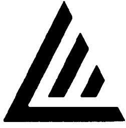
Working the Plan

A financial advisor's long-term value in investing.



The early stages of investment planning involve milestone events.[1] Most clients vividly recall these because their actions marked a new financial beginning.

Forming and implementing an investment strategy usually requires only a few weeks or months. But working that plan encompasses a lifetime. Your actions after the plan will significantly influence long-term performance—and untimely decisions or neglect can sabotage the best-conceived portfolio.

An experienced advisor understands this hazard and stays involved to help investors manage the challenge. Here's how:

■**Enforcing discipline.** An investment plan isn't an owner's manual to be filed away and forgotten. A plan is more like an exercise program requiring dedicated effort and mental tenacity.

An investment advisor assumes the role of a workout trainer by encouraging you to act consistently even when market conditions tempt you to do otherwise. But doesn't the plan enforce this discipline? Not according to research. For most people, having an investment plan doesn't guarantee prudent behavior. They still rely on an objective third party to help them stay on track with their plan. Consider these findings:

> A recent study of investor behavior concluded that written financial plans alone don't provide enough comfort for most consumers. An advisory relationship carries the authority of experience and skill, which motivates clients to follow their plan—and know why they are doing so.

> Despite the flood of educational materials and reports emphasizing a long-term approach to investing, consumers are thinking and acting with a short-term orientation. Their attempts to time markets have delivered returns much lower than index averages.

An effective advisor encourages accountability and provides qualified insight. This relationship builds an investor's confidence and rewards prudent decision making over the long term.

■**Applying new financial knowledge.** Like other dynamic industries and fields, finance is brimming with new theories and tools. This knowledge arises through quantitative sciences, such as mathematics, statistics and data processing. But investment theories also reflect behavioral factors, as described through economics and behavioral psychology.[2]

A well-sourced financial advisor stays abreast of academic studies and techniques affecting portfolio management. These improved methods of diversification, asset valuation and risk measurement ultimately become available to individuals. An advisor also must study related disciplines—including tax management and estate planning—to help coordinate other aspects of a client's financial plan.

■**Review and adjustment.** Today, advisors can apply sophisticated methods to improve performance and reduce risk. Most portfolios require stringent review and timely adjustment. This maintenance is systematic and proceeds mainly through:

> Monitoring—An advisor monitors each asset group and compares performance to appropriate benchmarks. The portfolio's total return and volatility are evaluated relative to expected long-term averages. Portfolios are reviewed to verify that their style and objectives remain in line with the client's investment policy.

> Reporting and communication—Results are organized and communicated regularly through performance summaries, semiannual reviews, newsletters and other means. An advisor also educates investors on market and portfolio principles, and provides updates to help manage their expectations of future performance.

> Portfolio adjustment—Over time, gains and losses will cause a portfolio to drift away from its prescribed asset mix. An advisor coordinates purchases and sales to reestablish an asset allocation consistent with the investment policy. (This is known as rebalancing.) Changes in a client's risk tolerance, growth/income objectives, time frame and financial condition may require other strategic action.

An advisor's perspective and objectivity may prove invaluable when changing conditions require a measured response. And in the investment world, such times are inevitable.

(1) Financial advisors have varying approaches to investment planning, which may include these stages:

- **Information Gathering.** Advisor explains investment philosophy and profiles client's investment personality, short-term and long-term goals, risk tolerance, time horizon and other financial considerations.
- **Evaluation.** Advisor reviews client's current financial condition and asset mix. An investment strategy appropriate for the client's investment profile is recommended.
- **Policy, Portfolio Design and Implementation.** Advisor creates an investment policy based on stated objectives and structures portfolio. Investments are chosen and held according to the prescribed allocation mix.
- **Monitoring, Maintenance and Rebalancing.** Advisor reports on performance and rebalances portfolio as needed. Advisor may assist in tax management, estate planning and other financial activities.

(2) Portfolio management encompasses both realms of study. Strategies and applications emerge from scientific inquiry. This research employs data analysis, statistical modeling and other tools of hard science. But the financial markets are driven by human attitudes and behaviors, which are not easily modeled through quantitative means.