Fact vs Fiction:
Why bespoke advice beats bespoke portfolios

Britain's wealth management industry is in need of big over haul. The bespoke portfolio – which is more likely to underperform than a centrally managed portfolio and cost your clients more – illustrates why this industry is ripe for change.

Imagine you take a client's pension and ISAs to a typical wealth manager. Arrive with £50,000 or £100,000 and you'll be politely ushered into one of their model portfolios, possibly with a degree of apology. Bring £250,000 or more and you're through to the 'VIP room' and your clients are given a bespoke portfolio. But the idea that a firm's 'model portfolio service' is somehow the poor relation is as perverse as it is outdated.

Many traditional UK wealth managers' websites and glossy brochures tell you that your clients need a bespoke investment portfolio, designed around their individual needs. This will be 'carefully constructed' in accordance with their 'unique objectives', creating an investment strategy that is individual to them. Their bespoke portfolio will be constructed and managed by their 'personal investment manager', to whom they have a direct line and who will meet with them regularly.

At first glance, this approach appears to make sense. After all, everyone is unique and has their own specific financial goals and reasons for investing: some investors may seek a comfortable income in retirement, while others may want a financial cushion for their family.

A closer analysis, however, sheds a different light. Each client has unique needs and individual circumstances, and therefore most certainly need individual – indeed bespoke – financial advice and planning. This is what you offer them. But does a bespoke investment portfolio make any sense?

Bespoke portfolios: the firm's best thinking… watered down just for you

Most wealth management firms employ a central team of specialist investment managers with many years' experience of investing. They spend all their time looking at the macro-economic picture, the financial markets and portfolio construction and risk management. They research, analyse and manage a set of asset allocations for diversified investment portfolios. Each of these 'model' portfolios reflects the 'best thinking' of these investment professionals for a specific risk-reward profile or set of investment constraints.

The upshot of this is that any subsequent change that a client adviser or 'personal investment manager' makes to the model portfolio allocations is, by definition, a move away from the firm's best thinking. To add insult to injury, the change has been made by someone significantly less qualified to do so than the specialist investment team – and who would want that?

Centrally-managed portfolios: the superior option… with a lower price tag

If your clients are given the choice of (i) a bespoke portfolio run by a 'personal investment manager' and (ii) one of the firm's model portfolios run by its central investment team, you should choose a model portfolio for them every time, even if the fee is the same.

Happily, the reality is that, in addition to providing the best investment allocations the firm has to offer, model portfolios should also provide the benefit of substantially lower fees. Because centrally-managed portfolios not only give your clients access to the highest expected returns of the firm, but are also significantly more cost effective than running a portfolio allocation per client.

For example, according to figures from Numis Securities, it costs an average of 1.8%* all-in to have a £500,000 discretionary portfolio managed by a UK wealth manager. The comparable cost of having the same sized portfolio managed centrally by Netwealth via the Transact Wrap Service would be 0.77% (made up of Netwealth's fee of 0.24% (inc. VAT), estimated underlying fund charges of up to 0.24% and Transact's platform charge of 0.29%).

This significant reduction comes from a vastly streamlined operational setup, and doing away with the expense associated with the salary and office costs of the personal investment managers. Of course, not all firms pass on the cost benefit – and if the wealth managers you choose for your clients don't, you should find one that does. A 1% cost saving may not sound that much, but its effect can be truly eye-watering compounded over many years. For example, with an average growth rate of 5%, the £500,000 portfolio with the total cost of 0.77% ends up being worth over £70,000 more in 10 years' time – and that's not even taking into account the fact that, by definition, model portfolios should have a

The best of both worlds: bespoke advice combined with centrally-managed portfolios

higher expected investment return. Ultimately, everyone's circumstances are different, and therefore financial advice and planning needs to be individualised. That's your area of speciality – and you are well placed to carry out this role.

You take into account your client's circumstances, their current assets and investments, their risk profile and their financial needs and goals. The process will result in a well-considered financial plan to give them the best chance of meeting their needs and goals.

However, once the planning is done, you need an investment team you can rely on. Each pot should be invested into the appropriate centrally-managed portfolio, to ensure their money is being managed by the best team for the job. Meanwhile, you and your client can arrange periodic check-ups on their financial plan and make any necessary course corrections.

Truly the best of both worlds.

*TER for the traditional wealth manager taken as the average TER of wealth managers listed in research by Numis and Citywire, as published by Citywire Wealth Manager in February 2015 (http://citywire.co.uk/wealth-manager/news/discretiary-fees-laid-bare-let-the-calculations-begin/a799209).

The value of your investments can go down as well as up and you may get back less than you invested.