THE COST OF MANAGING YOUR OWN WEALTH VERSUS A PROFESSIONAL MANAGER

COMPLIMENTARY GUIDE

Introduction

In recent years it has become much easier for individuals to manage investments themselves. The rise of “fund supermarket platforms” like Hargreaves Lansdown is to be welcomed.

These platforms have helped reduce costs, played a vital role in supporting and educating investors and made possible the rise of the DIY investor.

Arguably, they’ve also put pressure on the professional wealth management industry to raise its game, communicate with greater clarity and become leaner and more efficient – in turn reducing charges.

So is DIY investing now the cheap option? Or could it be that you might be better off with a professional manager?

The average annual cost of wealth management services accessed via *findaWEALTHMANAGER*.com ranges from around 1.1% to 1.7%. Many DIY investors might be surprised to find their own costs come in higher than that.

This guide aims to look at the true cost of investing

DIY Costs: Getting It Wrong

We’ll address the actual price of DIY and professional management shortly, but first it’s important to consider the whole picture.

There are some broader costs in taking the DIY route – primarily, the cost of getting it wrong.

One of the most expensive mistakes many DIY investors make is being over-adventurous. A little knowledge is a dangerous thing.

When markets are rising – as they have significantly since the financial crisis of 2008/2009 – it can be easy to convince yourself that you’re an investment natural. But there’s a saying in the industry: “A rising tide floats all boats.”

As the legendary investment guru Warren Buffett warned: “Only when the tide goes out do you discover who’s been swimming naked.”

Is the investment portfolio you’ve built strong enough to withstand a storm? Is it properly diversified? DIY investing is a false economy if you save 1% in charges but lose 10% because of investment mistakes.

Having a diversified portfolio with your money in the right places at the right time is hugely important but very difficult to achieve on your own or without using costly professional multi-asset funds that cover the full range of investment assets, such as equities, bonds, property, commodities and gold.

Assets that top the performance tables one year can often plummet the next. This suggests that what’s needed is active management.

Three Common DIY Investor Mistakes

- **Buying high, selling low** – Investors get swept up by a stock or fund that's rising and confidently dive in, but by the time most people jump on a bandwagon the wheels are about to fall off. Similarly, when markets plummet too many investors panic and sell. Warren Buffett again comes to mind: "Be fearful when others are greedy and greedy when others are fearful."

- **Over-trading** – This links with the previous point. DIY investors are often too tempted to act on weekend newspaper tips and end up constantly buying and selling – running up significant transaction costs that hamper performance.

- **Under-diversification** – A key way to reduce risk is to diversify geographically and across asset types. Many investors fail to do this. Sometimes they think they're diversified when they're not. There's a strong correlation, for instance, between emerging markets and commodities: holding both isn't necessarily diversification.

At the other end of the spectrum are the "recklessly cautious" investors. Scared by sensationalist stories about shares plummeting, they leave their money in cash accounts – earning so little interest that the value of their savings is slowly eroded by inflation.

Alternatively, they might have huge exposure in their portfolio to government bonds (also known as treasuries or gilts). These are traditionally considered the lowest risk after cash and have historically generated one or two per cent above cash.

That has changed during the era of quantitative easing, with government bonds delivering unprecedented returns. Many professional experts are now worried about a bond market bubble. Investors who thought there were exposed to little risk may find themselves in trouble if the bubble bursts.

DIY Costs: Time and Worry

Another challenge for many DIY investors is time. A professional investment team will be monitoring markets constantly, seeking opportunities to enhance returns or reduce risk and acting quickly.

Many DIY investors don't have that luxury (which can sometimes actually be a good thing, given the tendency to over-trade).

Some DIY investors are able to check the markets regularly, of course, and a few years ago a study by investment platform AJ Bell suggested many do. It found three quarters went online once a week to monitor their portfolios, one in eight went online every day and one in 14 went online several times a day.

For these investors the issue is often a different one – or at least it is for their families. Is this a good use of time? Could that time be better spent elsewhere? The cost of DIY investing may not be a financial one, but there is what economists might call an opportunity cost.

Another non-financial cost that needs to be taken into account is the stress of DIY investing. Many people start out enjoying running their own money – particularly if they have a good

opening streak – but the risk of investment failure can become a creeping worry as markets turn or as their wealth grows and they get ever closer to retirement.

Many of *findaWEALTMANGER.com*'s clients are DIY investors who have reached this point. They no longer enjoy managing their own money – or at least not all of it. We often find the solution is to appoint a wealth manager to be responsible for the core of their investments but to leave them a much smaller satellite portfolio so they can continue to pursue their hobby without quite the same stress. A satellite portfolio may also work when an individual has a deep knowledge of a particular industry or sector and feels able to add value in this area.

Can a Wealth Manager Generate Better Returns?

Costs are only one side of the equation. What about returns?

There's growing concern that stock markets are coming to the end of a long, generally positive run (a bull market) and that we're entering a much more difficult, negative phase (a bear market). With interest rates so low, it's certainly becoming harder to generate attractive returns. Can a professional wealth manager do better?

The answer in most cases is a resounding "yes". Professional investors have at their disposal much more sophisticated data resources; they typically have teams of specialists in different asset classes; and they're often able to meet senior fund and company managers face to face. So they're better informed.

Their scale means they also have access to some superior institutional funds not normally available to an individual investor. At the most sophisticated end of the market they can offer opportunities in areas like private equity and private debt. These may not be liquid – in other words, they can't be quickly and easily sold – but they can generate significantly enhanced returns.

In short, we believe professional managers are often much better placed to identify and execute strategies to reduce risk and seize opportunities that can affect performance.

The Actual Costs

Earlier we explored the costs of DIY and professional wealth management in the broadest sense. It's time to look at some of the more obvious costs – and the findings may surprise.

DIY investing isn't necessarily cheap. Research suggests an investor who has a £1 million portfolio, with most money invested in ordinary funds and trading infrequently, could easily be paying 0.25% a year in platform costs alone. If your portfolio is £250,000 then it could be as much as 0.42% a year.

In addition, the fund managers themselves will charge fees. These tend to range between 0.5% and 1%. Passive funds are cheaper – sometimes less than 0.1%, though typically 0.5% or more for non-UK funds.

Known as Exchange Traded Funds (ETFs) or trackers, these passive vehicles often seek to replicate an index (like the FTSE 100), though they usually slightly underperform because of charges. The difference between the buy and sell price (known as the bid-offer spread) is an additional cost to consider. Passive investing isn't as cheap as is often suggested.

An active manager will seek to outperform the index to justify their charge. Though there's lots of evidence to suggest many fail, there are plenty with outstanding track records.

If you use a multi-manager (also known as a fund of funds manager), essentially leaving someone else to build the portfolio of funds you own, the charges are greater still – usually between 1.25% and 1.65%.

One of the great boasts of the fund platforms is that they've reduced or eliminated initial fees. These used to be as much as 5% of the initial investment, so the platforms and discount brokers deserve plaudits for their success in this area. But there remain some hidden costs.

The bid-offer spread issue we raised when discussing ETF charges can apply to some funds, too. On some (including the popular Hargreaves Lansdown multi-manager portfolios) it can be as much as 5%, which looks suspiciously like an initial fee in disguise.

This essentially means that if you're building your own portfolio and watching the charges you might get costs down to between 0.75% and 1.4% a year, depending on the size of your portfolio.

Investors paying so little are likely to have pre-dominantly exchange-traded funds (ETFs) and direct equities alongside some specialist funds.

If you're using a one-stop solution like a multi-manager fund the charges could be nearer 1.5% or even over 2% a year – and you could also face a charge of up to 5% in initial costs of some form or other. In this case you're almost certainly likely to be better off with a wealth manager.

The Wealth Management Alternative

We've seen reports suggesting that total charges for discretionary wealth management services[1] are typically 3.65%. This figure almost certainly includes financial adviser fees on top of wealth manager fees.

Financial advisers tend to specialise in financial planning and tax planning – helping you to work out issues like how much you need to save for retirement, estate planning and how to invest tax-efficiently. Some have the expertise and qualifications to manage money, but it's not something most specialise in and often they outsource this responsibility to a wealth manager or investment manager – creating two layers of charging.

We're not comparing apples with apples if we include these financial planning costs, but we raise this issue because increasingly we're seeing wealth managers provide many of the financial and tax planning services that used to be the domain of financial advisers – often on a one-off chargeable basis, as needed. For most people this should cost no more than £1,500 every three to five years, so there are some considerable savings to be made. At its most basic level, tax planning can often be included in the wealth management service, leaving many investors to ask if they need a financial adviser any more.

Tax itself is a significant cost, and having a professional adviser who's alert to the opportunities to reduce your tax bill is a huge benefit that can't be ignored.

But for now let's put those tax planning costs to one side.

Excluding financial adviser charges, the average cost for wealth management services on the findaWEALTHMANAGER.com platform ranges from around 1.1% to 1.7%. This includes underlying fund costs.

In other words, for some people using a wealth manager may actually be cheaper than taking the DIY route.

How is this possible? One of the key reasons is that the wealth management industry has had to become more efficient in recent years because of the growth of the platforms. But wealth managers also have scale and buying power and can often secure funds at cheaper institutional prices.

The bigger *your* portfolio, the less you're likely to be charged as a percentage – and the bigger the discounts you can negotiate.

In Summary

We find the expertise of a good wealth manager in protecting your wealth and generating positive returns usually more than offsets any charges. Fees are obviously important, but we recommend you focus on returns **after** a wealth manager's fees. Over the long term this figure should be between 3% and 6% a year above inflation, depending on your risk profile and portfolio size (clearly, the more sensitive you are to investment risk, the lower the return you should expect).

DIY investing can be cheaper. We don't dispute that. But not that much cheaper, and for some investors the real costs – the costs of failure, the costs of missed tax savings and the opportunity costs of the time spent managing money – can actually make DIY investing very expensive indeed.

If you haven't considered using a wealth manager before – or if you haven't reviewed your existing manager to check their competitiveness – take our simple test today.

[1] More than 70% of *findaWEALTHMANAGER.com* users opt for a discretionary service. This is where the wealth manager ascertains your objectives and attitude to risk and builds a portfolio to meet your specific needs. You then give the manager discretion to make changes to the portfolio as and when they see the need, without having to go through the lengthy process of getting your prior approval.

Find A Wealth Manager is an independent service designed to help clients navigate the opaque world of finance and wealth planning. We partner with the leading UK firms who commit to best practice and better value fees. Use our configurator to get matched to the right firm and then our experienced team will help you meet your best placed manager.

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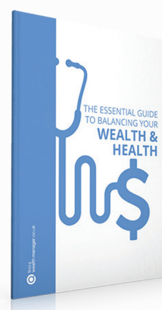

The Essential Guide to Balancing Your Health & Wealth

A Wealth Check for Smart Investors

findaWEALTHMANAGER.com
T: +44 (0) 207 193 5691 | E: ukteam@findawealthmanager.com
A: Alpha House, 100 Borough High Street, London SE1 1LB, UK

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