The importance of a financial adviser, tangible versus intangible assets

By **Patricia Holburn** on November 30, 2012

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Is it really a good idea to cut out the middle man?

South Africans' reluctance to pay for professional financial advice has a price

Many investors approach financial service providers directly because they believe they can get a better deal by cutting out the 'middle man', the financial adviser. Getting appropriate financial advice is, however, essential to your financial wellbeing – it mobilises you to take action when needed and helps you manage risks. Why are so many investors hesitant to get professional advice? This disconnect can largely be attributed to a focus on the costliness of financial advice, instead of the actual value of the advice.

Financial advice plays a key role in retirement planning, which is very relevant to South Africa

One of the most critical benefits of sound advice is preparing for a comfortable retirement. South Africans generally save far too little to generate adequate retirement income. Hamilton van Breda, head of Retail Sales at Prudential confirms this problem: "This unfortunate situation is fuelled by the knowledge gap between consumers and the complex financial issues that affect them. Financial advisers can play a critical role in helping people save enough money for retirement."

Financial planning gives you more control over the risks inherent to investing

There are many risks involved in not providing for retirement, including an unexpected reduction in income due to poor market returns, inflation decreasing the real purchasing power of money, and exposure to failing financial institutions and fraudulent schemes. "Because most of these risk factors are beyond our control, investors should embrace appropriate financial planning as the one risk-reducing measure that they can control," explains Van Breda.

Over the long term, quality financial advice is worth more than its cost

People who use a financial adviser benefit by having peace of mind, greater control over their finances, avoiding bad investments, sticking to a budget, finding it easier to save and improving their retirement prospects. Van Breda says the hefty debates and criticisms of the cost of financial advice in South Africa have kept many people from approaching a financial adviser. "There has been a strong regulatory and consumer media-driven focus on reducing the cost of advice and improving the quality of financial advice. However, there is seldom any reference to the value of the advice," he explains.

Van Breda believes that investors will have a better financial outcome if they seek quality financial advice. Advisers can make recommendations on a diverse range of products and services such as life insurance, employee benefits, tax planning, estate planning, risk management, investment and retirement planning. The value they add in all these aspects can far outweigh the costs.

Financial advisers have guidelines to help ensure their advice is in their clients' best interests

The Financial Advisory and Intermediary Services (FAIS) Act gives financial advisers very specific guidelines to follow. When it comes to giving advice, the Act stipulates that advisers must:

take reasonable steps to get information about their client's financial situation, financial product experience and objectives,

conduct an analysis based on this information, and

identify the financial product or products that will be appropriate to the client's risk profile and financial needs.

Financial advice helps you protect your money in challenging times

Financial advisers should be able provide tangible benefits to their clients, such as wealth creation and protection. They should help investors make an informed decision in a relatively complex and bewildering environment. This is now more relevant than ever. Investors are nervous, but if they seek advice from a financial adviser, the adviser can provide them with strategies to safeguard investments and assets. Advisers can help curb irrational investor behaviour.

The debate about adviser remuneration has impacted people's perception of advice negatively

"The debate over whether financial advisers should receive explicit fees linked to advice given or commission received is always a heated one. However, it becomes a real problem when any fees or 'additional' charges discourage people from investing," says Van Breda.

Quality financial advice is worth the cost in the benefits of sound financial planning

According to Van Breda potential investors need to understand the role and value of financial advice. Financial advisers offer a valuable service and they deserve to be reimbursed in a transparent and open way. Van Breda believes a focus on value, not cost, will enable investors to reap the benefits of professional advice. "When the benefits of financial advice outweigh the expected costs of the advice, investors will be more willing to engage the services of a financial adviser. At the same time, financial advisers should be properly qualified and ethical in their treatment of their clients' important life decisions," he says.

Tangible assets are often first choice as investments – with detrimental effect

Human beings have five overt senses and we derive a level of comfort from engaging them. It is this very attribute of being human that can sway our investment choices too – often with abysmal results.

A favourite asset class amongst investors is property: you can see it and touch it; it can be bought with other people's money and so the returns can be leveraged; it can be leased and so produce an income. It is an asset that is generally understood.

But property investment has some serious shortcomings.

This is according to Morris Crookes of Foord Asset Management who says that for many people, a property investment is often a very substantial proportion of their overall portfolio. Consequently, such investors are often over-exposed not only to a single asset class, but to a single asset within that class.

“The price of a property is not readily determinable until a willing buyer agrees a price with a willing seller. Furthermore, a property is not something that can necessarily be turned into money immediately: the processes of transfer, conveyancing and registration mean that there is an inevitable delay between a transaction and the realisation of cash. Further still, the costs of buying, selling, maintaining and insuring property are not inconsequential.”

Tangible assets are not limited to property, of course. Investors have also invested in non-income yielding corporeal assets such art, Persian rugs and gold coins (which have enjoyed particular attention over recent times with the prodigious increase in the gold price).

“For the average investor, the issues of over-capitalisation, illiquidity, carrying costs (storage, maintenance and insurance) and lack of diversification remain. In many instances, a true understanding of the nature and behaviour of the tangible asset is also lacking. For example, does the average person know how Persian rug values have moved or can expect to move in the future?” asks Crookes.

It is for these reasons that investors must be encouraged to look beyond the obvious comfort of tangible, tactile assets.

This requires us to challenge our own beliefs and investor behaviour. “Without doubt, it is more difficult to appreciate something that we cannot see. It is more difficult to extrapolate those abstractions over the long term without the benefit of sensory cues. It is more difficult, but it is necessary in order to achieve an optimal investment outcome.”

“The issue is not that tangible assets are bad of themselves, and the rampant sale of properties and homes is not being encouraged,” says Crookes. “However, for the average investor, it is impossible to build a suitably diversified, liquid portfolio if too much focus and capital is placed on and in tangible assets. Cash is not king. But the inability to timeously convert an investment into cash at a value that is readily determinable can make for catastrophic investing.”

“In the childhood game of “rock, paper, scissors,” it is clear that no one attribute trumps all others. Each has its strength. In the same vein, a preoccupation with tangible assets amounts to a forfeit of other investment imperatives such as liquidity and diversification. These key characteristics of diversification and liquidity are inherent in an entirely intangible investment in a collective investment scheme (unit trust), particularly one that offers exposure to different asset classes and geographies,” concludes Crookes.