The Future of Advice

Communicating Adviser Value in a fee based world

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Vanguard

Agenda

Adviser landscape – importance of the adviser

Communicating fees to clients

Areas advisers add value over and above a DIY outcome?

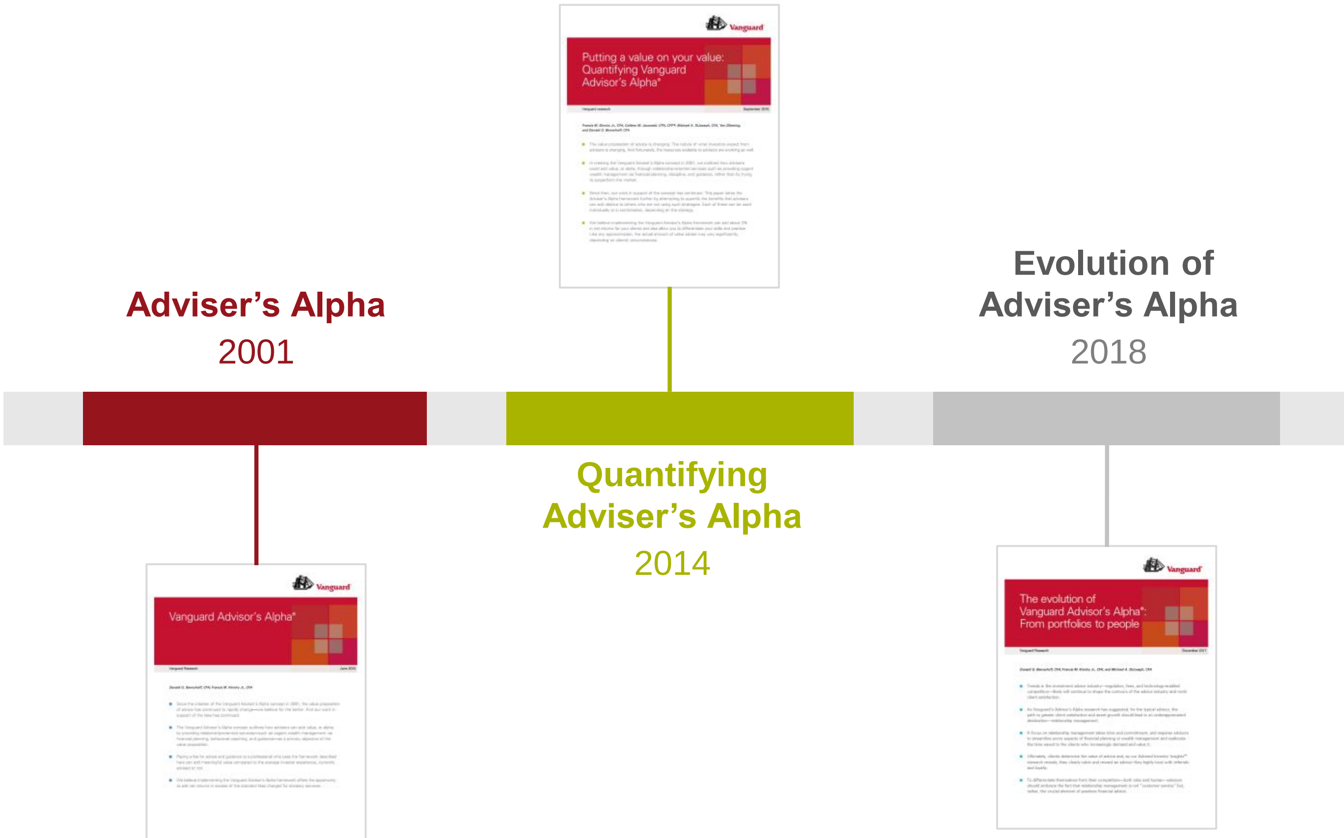
Behavioural coaching – key to unlocking client planning success

Q&A & next steps

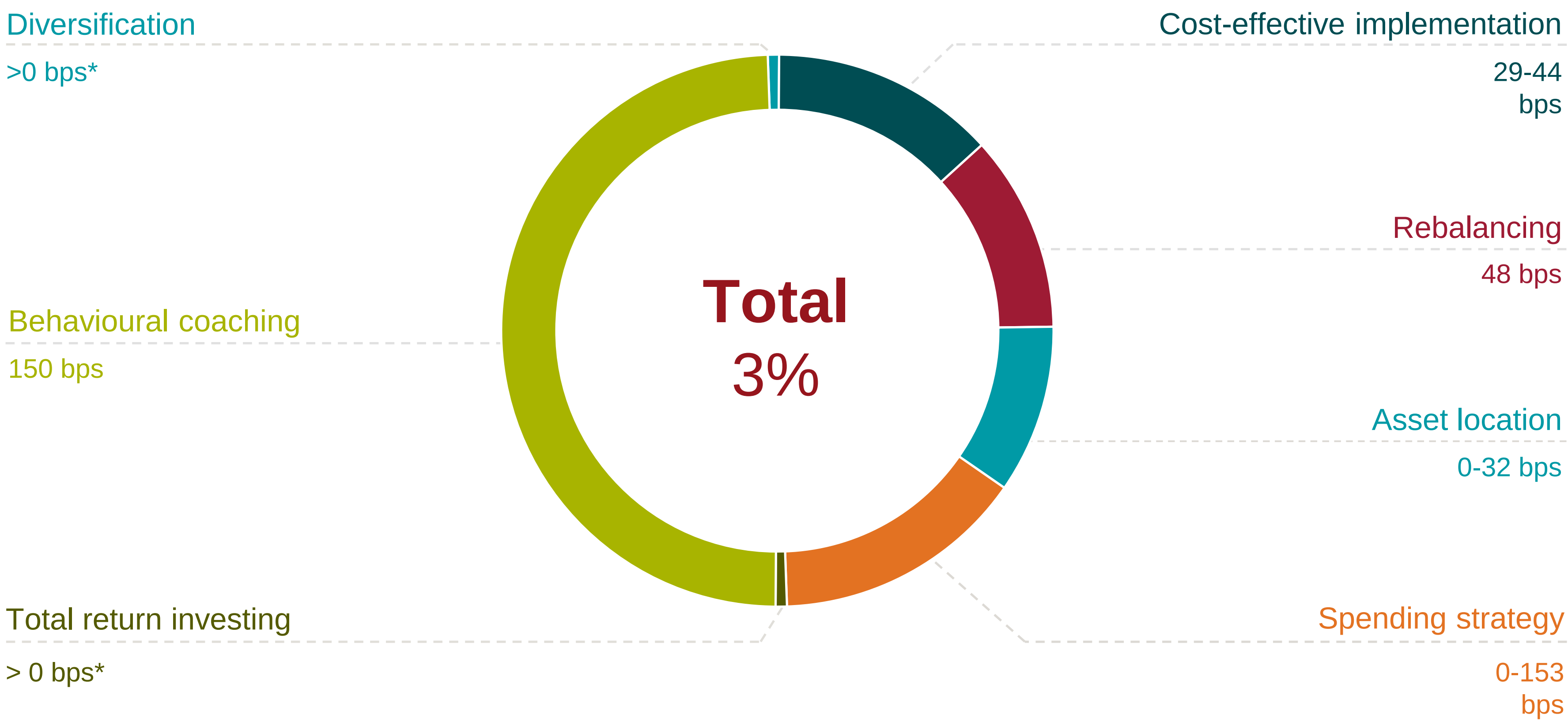
"The adviser's job is to help their clients **avoid making costly mistakes**"

John C Bogle

Adviser’s Alpha timeline



Adviser’s Alpha framework



Source: Vanguard.

The value of an adviser…

About 3%

Source: Vanguard, as at June 2020.
(1) “About 3%” means 3 percentage points of additional net return over an unspecified period of time.

Advice landscape

Demand for advice is rising...

£521bn

£64bn

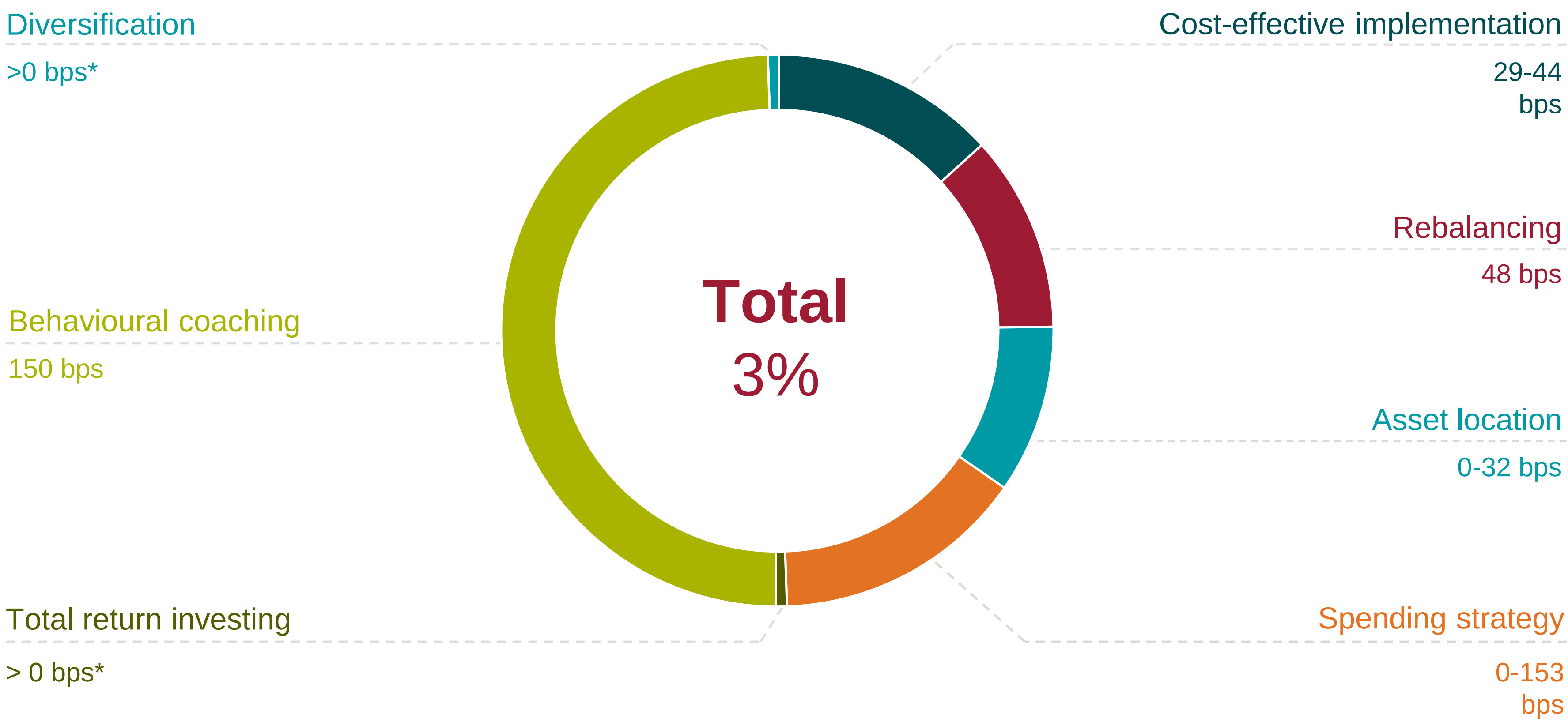
Sources: FCA, Platforum

But the landscape is evolving...

	Manufacturing Fund	Administration Platform	Distribution Advice	
2010				bps
2020				bps

Source: Vanguard

Adviser’s Alpha framework



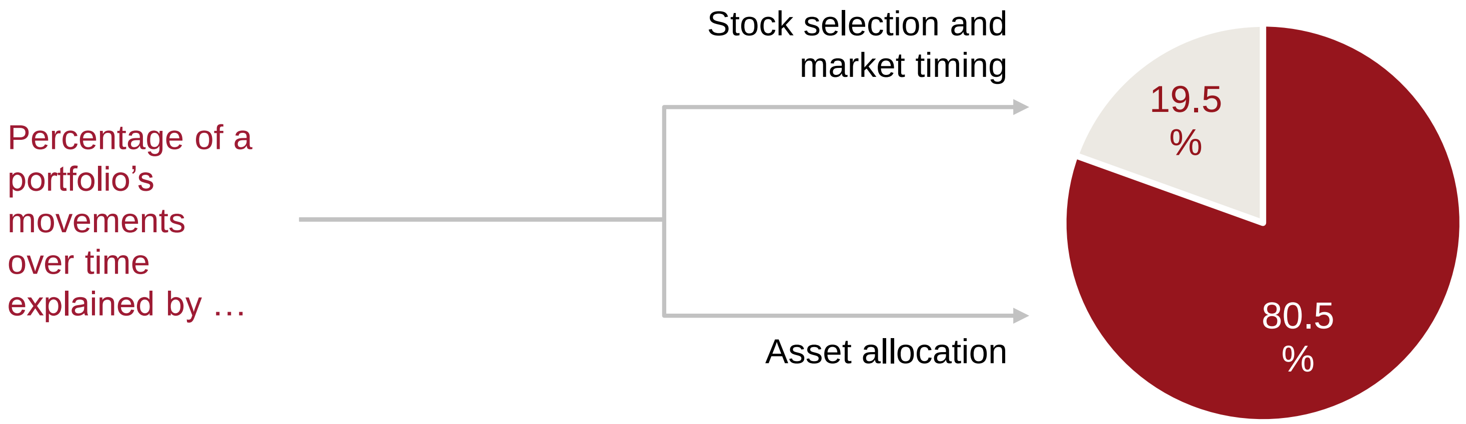
Source: Vanguard.

Asset allocation

1. Asset allocation

Adviser Alpha Value
>0 bps

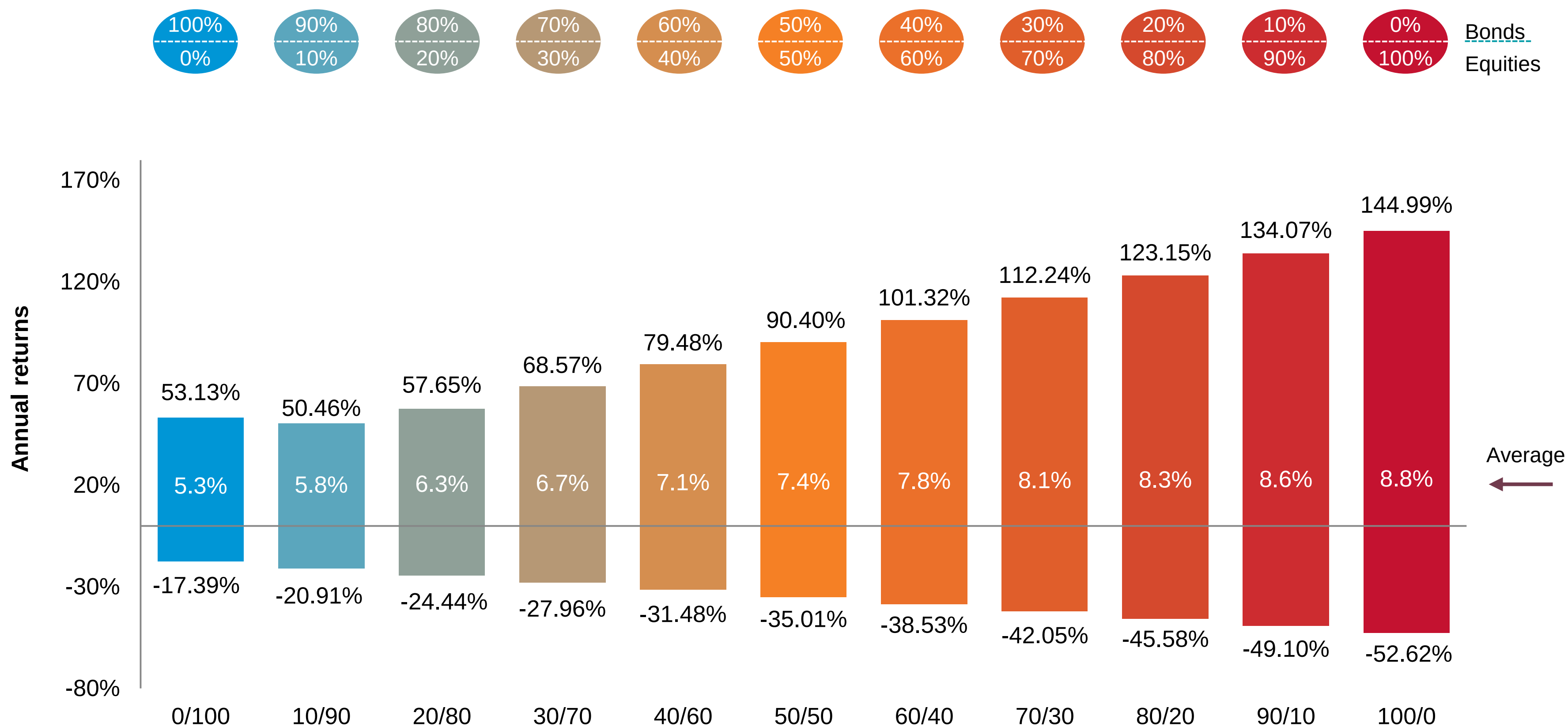
Investment outcomes are largely determined by the long-term mixture of assets in a portfolio



Source: Vanguard calculations using data from Morningstar.
Note: Calculations are based on monthly returns for 743 UK balanced funds from January 1990 through September 2015. For details on the methodology, see the Vanguard research paper The global case for strategic asset allocation and an examination of home bias (Scott et al., 2017).

1. Asset allocation: The mixture of assets defines the spectrum of returns

Best, worst and average returns for various equity / bond allocations, 1901-2019



Past performance is not a reliable indicator of future results.

Source: Vanguard. Notes: Reflects the maximum and minimum calendar year returns, along with the average annualised return, from 1901-2019, for various stock and bond allocations, rebalanced annually. Equities are represented by the DMS UK Equity Total Return Index from 1901 to 1969; thereafter, equities are represented by the MSCI UK Index. Bond returns are represented by the DMS UK Bond Total Return Index from 1901 – 1985; the FTSE UK Government Index from Jan 1986 – Dec 2000 and the Bloomberg Barclays Sterling Aggregate Index thereafter. Returns are in sterling, with income reinvested. Data period from 1 January 1901 to 31 December 2019. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

There is little persistence in asset class performance

Key index returns (%), ranked by performance

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
20.1	37.4	13.0	62.5	23.6	20.3	17.8	28.3	19.6	8.8	35.4	21.1	0.8	26.5	16.5
16.8	15.7	7.6	30.1	21.3	16.7	15.5	25.2	18.8	5.5	34.1	17.2	0.5	22.3	13.0
16.8	10.8	3.6	21.2	19.1	6.5	12.8	21.0	14.6	5.3	29.6	16.9	0.1	21.2	12.8
7.2	8.3	-10.0	20.1	16.7	5.8	12.3	20.8	12.5	4.0	25.5	13.8	-0.4	19.2	11.9
3.3	6.6	-13.2	14.8	14.5	1.2	12.0	13.6	11.3	1.4	25.4	13.1	-2.2	15.9	11.3
2.8	5.8	-13.3	14.7	8.9	-3.5	11.2	1.6	7.9	1.0	21.2	11.3	-3.4	14.0	9.1
1.7	5.6	-19.4	13.6	8.7	-6.6	10.7	0.6	7.9	0.7	16.8	4.9	-7.6	11.0	8.9
0.8	5.3	-24.0	6.3	7.5	-12.6	5.9	0.0	2.8	0.5	12.3	2.5	-8.0	7.1	7.8
0.5	5.2	-29.9	5.3	5.8	-14.7	2.9	-4.2	1.2	-1.1	10.7	2.0	-9.1	6.5	5.0
-0.2	0.4	-34.8	-1.2	4.8	-18.4	0.6	-5.3	-1.4	-10.3	3.7	1.9	-9.5	6.3	-9.8

- Global equities
- North American equities (US/Canada
- Emerging market equities
- Developed Asia equities
- European ex UK equities
- UK equities
- UK government bonds (gilts)
- UK index-linked gilts
- UK investment grade corporate bonds
- Hedged global bonds

Past performance is not a reliable indicator of future results.

Source: Vanguard calculations, using data from Barclays Capital and Thompson Reuters Datastream. UK equity is defined as the FTSE All Share Index, European ex-UK equity as the FTSE All World Europe ex-UK Index, developed Asia equity as the FTSE All World Developed Asia Pacific Index, North America equity as the FTSE World North America Index, emerging market equity as the FTSE Emerging Index, global equity as the FTSE All World Index, UK government bonds as Bloomberg Barclays Sterling Gilt Index, UK index-linked gilts as Bloomberg Barclays Global Inflation-Linked UK Index, hedged global bonds as Bloomberg Barclays Global Aggregate Index (hedged in GBP), UK investment grade corporate bonds as Bloomberg Barclays Sterling Corporate Index. Returns are denominated in GBP and include reinvested dividends and interest.

Cost effective implementation

2. Cost effective implementation (expense ratios)

Adviser Alpha Value
29 - 44 bps

Asset-weighted expense ratios versus "low-cost" investing

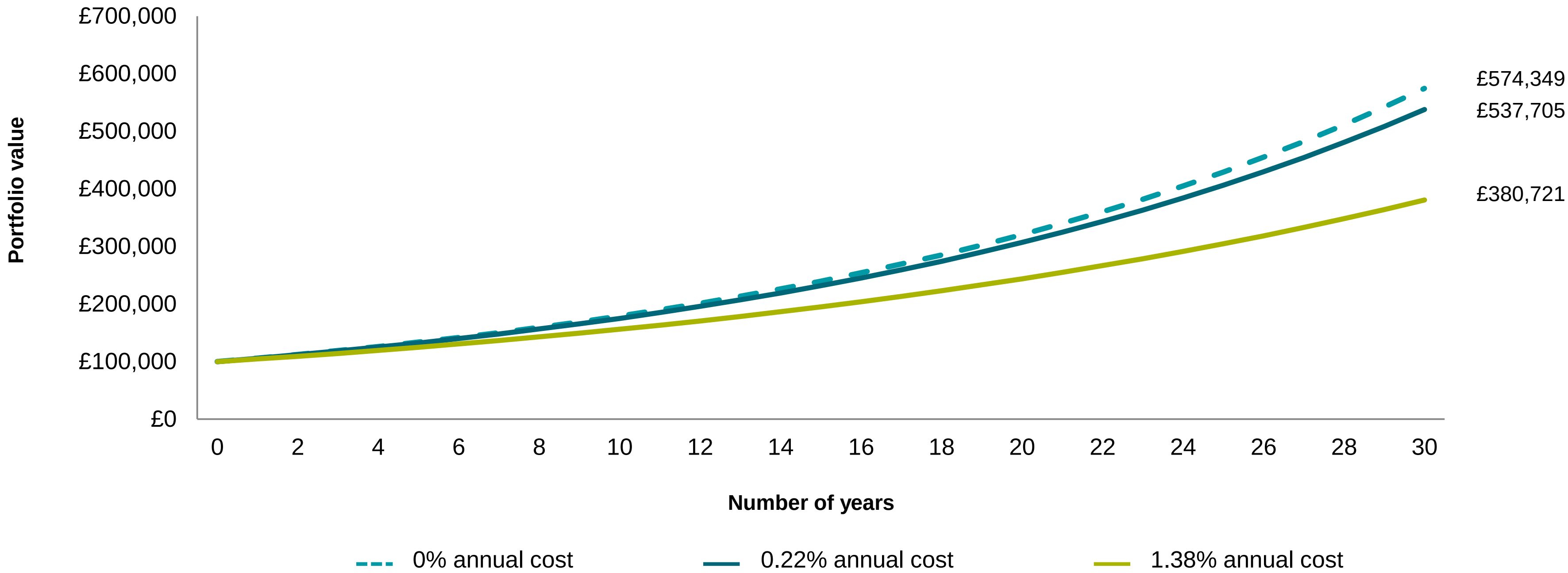
Equity/bond mix (%):	100/0	80/20	60/40	50/50	40/60	20/80	0/100
Asset-weighted expense ratio (AWER)	0.66	0.62	0.58	0.56	0.54	0.50	0.46
Quartile 1 AWER (Q1)	0.22	0.21	0.20	0.19	0.19	0.18	0.17
Cost-effective implementation (AWER vs. Q1)	0.44	0.41	0.38	0.36	0.35	0.32	0.29

Sources: Vanguard calculations, based on data from Morningstar, Inc., as at 31 December 2018.
Notes: Fund universe includes funds available for sale in the UK, from the following Morningstar categories: UK equity – flex cap, large-cap blend, large-cap growth, large-cap value, mid-cap, small-cap; Europe equity – Europe OE: flex-cap, large-cap blend, large-cap growth, large-cap value, mid-cap, small-cap; Euro zone equity – flex-cap, large-cap, mid-cap, small-cap; Global – flex-cap, large-cap blend, large-cap growth, large-cap value, mid-cap, small-cap; US equity – flex-cap, large-cap blend, large-cap growth, large-cap value, mid-cap, small-cap; Emerging markets equity – emerging markets; Europe bond – EUR diversified; US bond – USD diversified; Global bond – global un-hedged bond; UK bonds – UK diversified, UK government.

2. Cost effective implementation: Costs, like interest, compound over time

Adviser Alpha Value
29 - 44 bps

Assuming a starting balance of £100,000 and a yearly return of 6%, which is reinvested



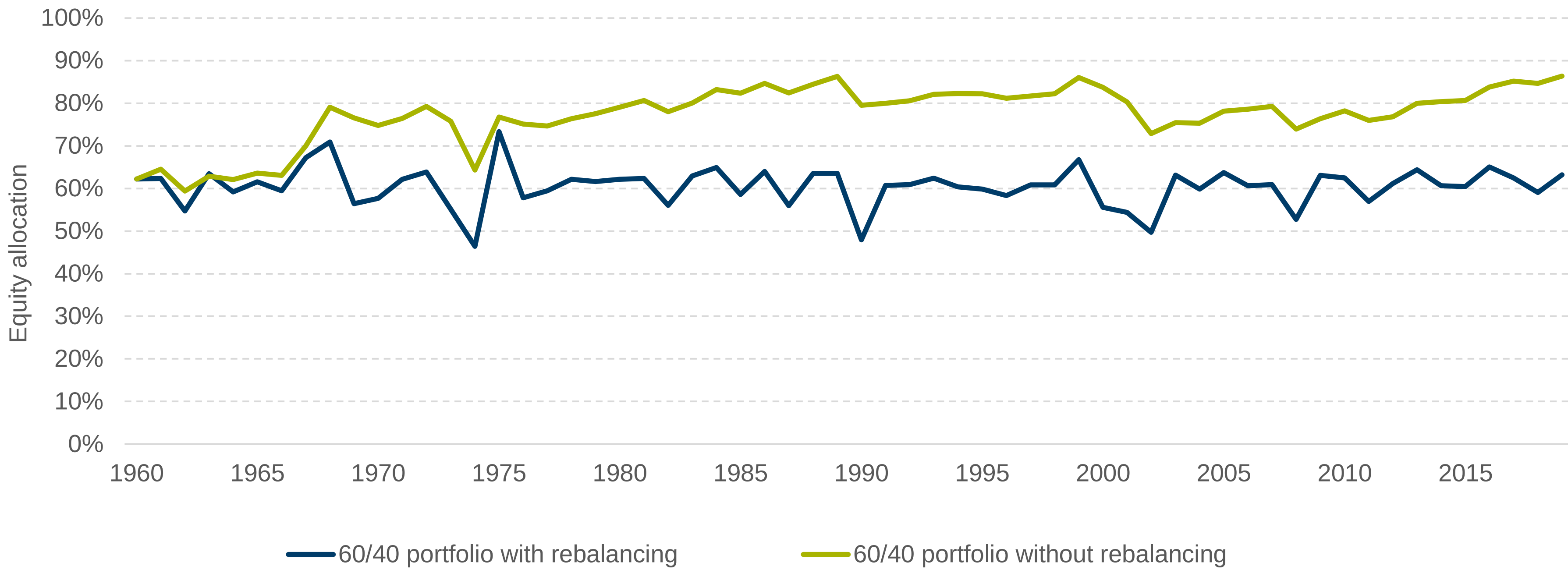
Source: Vanguard
Note: The portfolio balances shown are hypothetical and do not reflect any particular investment.
The final account balances do not reflect any taxes or penalties that might be due upon distribution.

Rebalancing

3. Rebalancing

Adviser Alpha Value
0 - 48 bps

Equity allocation of 60%/40% equity/bond portfolio rebalanced annually and non-rebalanced, 1960-2019



Past performance is not a reliable indicator of future results.
Source: Vanguard calculations, based on data from Thomson Reuters Data stream and Bloomberg Barclays.
Notes: The initial allocation for both portfolios is 60% global equity and 40% global bonds. The rebalanced portfolio is returned to this allocation at the end of each June and December. Global equity is defined as the MSCI All Country World Investable Market Index, GBP un-hedged. Global bonds are defined as the Bloomberg Barclays Global Aggregate, hedged to sterling. Returns are in GBP with income reinvested.

Behavioural coaching

Adviser is client’s emotional circuit breaker…..

4. Behavioural coaching

Adviser Alpha value **150 bps**

There is significant scope to improve returns by counteracting behavioural bias

Typical behavioural biases:

- Anchoring
- Confirmation
- Framing
- Loss aversion
- Overconfidence

Estimated value add of behavioural coaching:

0 bps — 150 bps — 200 bps

Vanguard estimate[1]

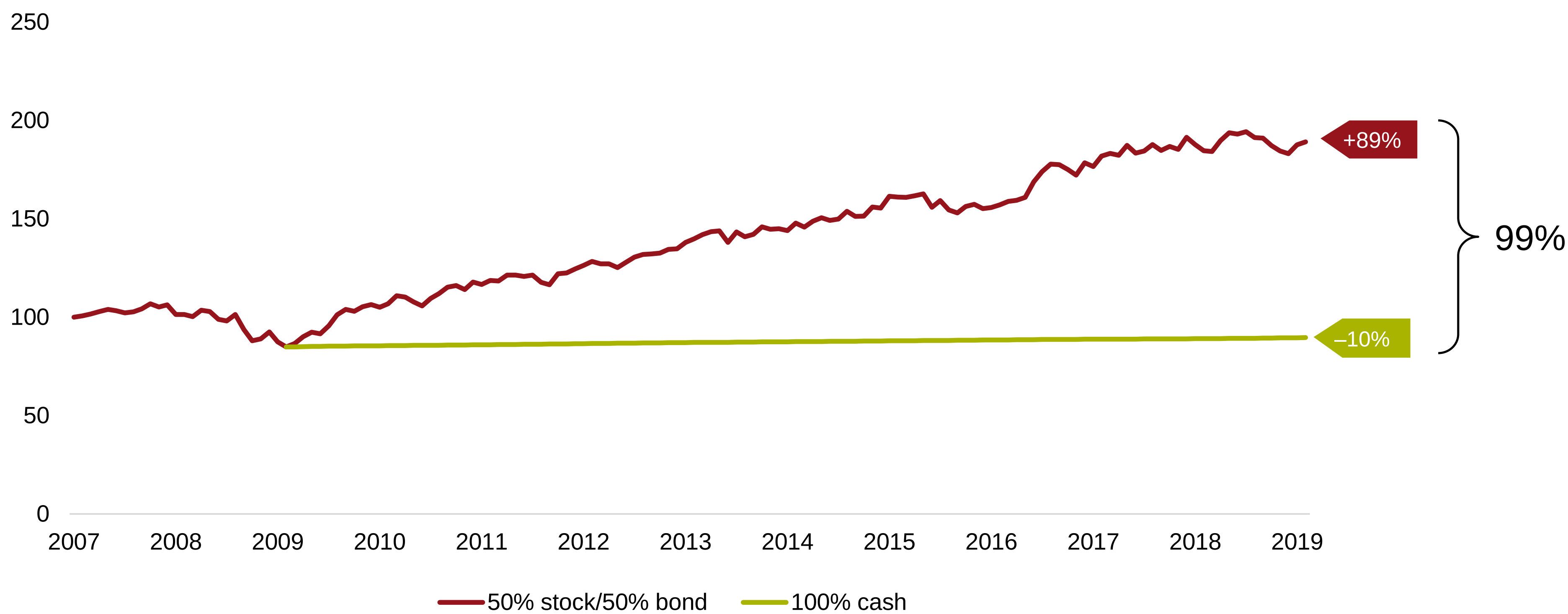
- ✓ **Behavioral coaching can add percentage points** – rather than basis points – of value to the relationship
- ✓ Third party studies have concluded that behavioural coaching can add up to an average of **approximately 200 basis points per year**
- ✓ Vanguard's studies suggest the **figure is roughly 150bps[1]**

Source: Vanguard.
(1) By comparing 58,168 self-directed investor's personal returns for the five years ended 2012 versus hypothetical results using two Vanguard created 'personal rate of return benchmarks' based on single fund alternatives, we found that the average fund investor who made at least one change to their portfolio sacrificed 104 to 150 bps due to poor portfolio adjustments (Weber, 2013).

Behavioural coaching: The importance of discipline

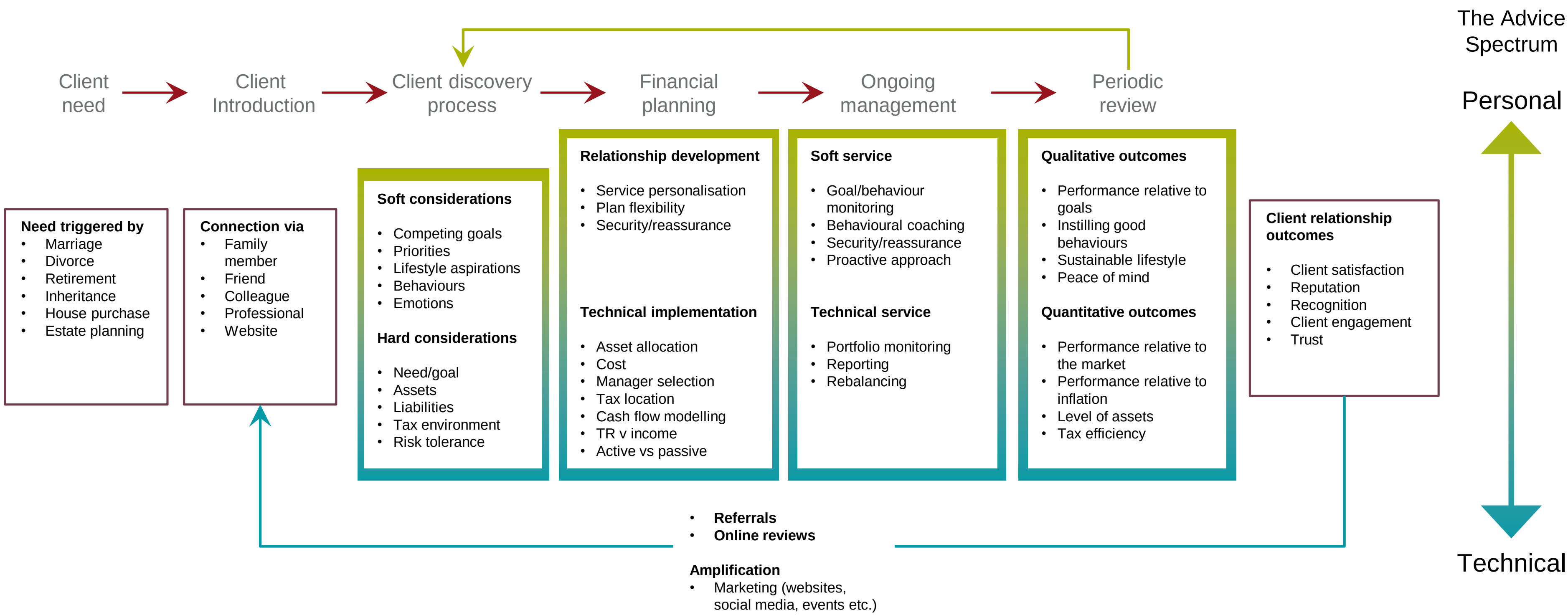
Adviser Alpha Value
150 bps

Value of a hypothetical £100 invested at the beginning of 2007



Past performance is not a reliable indicator of future results.
Source: 50% stock/50% bond portfolio represented by 50% FTSE 100 Index and 50% Bloomberg Barclays Sterling Aggregate Bond Index (rebalanced monthly). 100% cash represented by ICE LIBOR 1-month GBP. Data provided by Morningstar, Inc. and Vanguard calculations. Data period from 1 January 2007 to 31 December 2018. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Map of client-adviser journey



5. Tax allowances and asset location

Adviser Alpha Value
0 - 32 bps

- Asset location is worth 0 - 32 bps in the first year… compounded
- The allocation of assets between taxable and tax-advantaged accounts can add value each year that can compound through time
- UK investors can minimise the impact of taxes by:
  - holding tax-efficient broad-market equity investments in taxable accounts
  - holding broad-market bonds within tax-advantaged accounts
- Value added depends on the investor’s asset allocation, tax-band and the breakdown of assets between taxable and tax-advantaged accounts

6. Withdrawal order for client spending

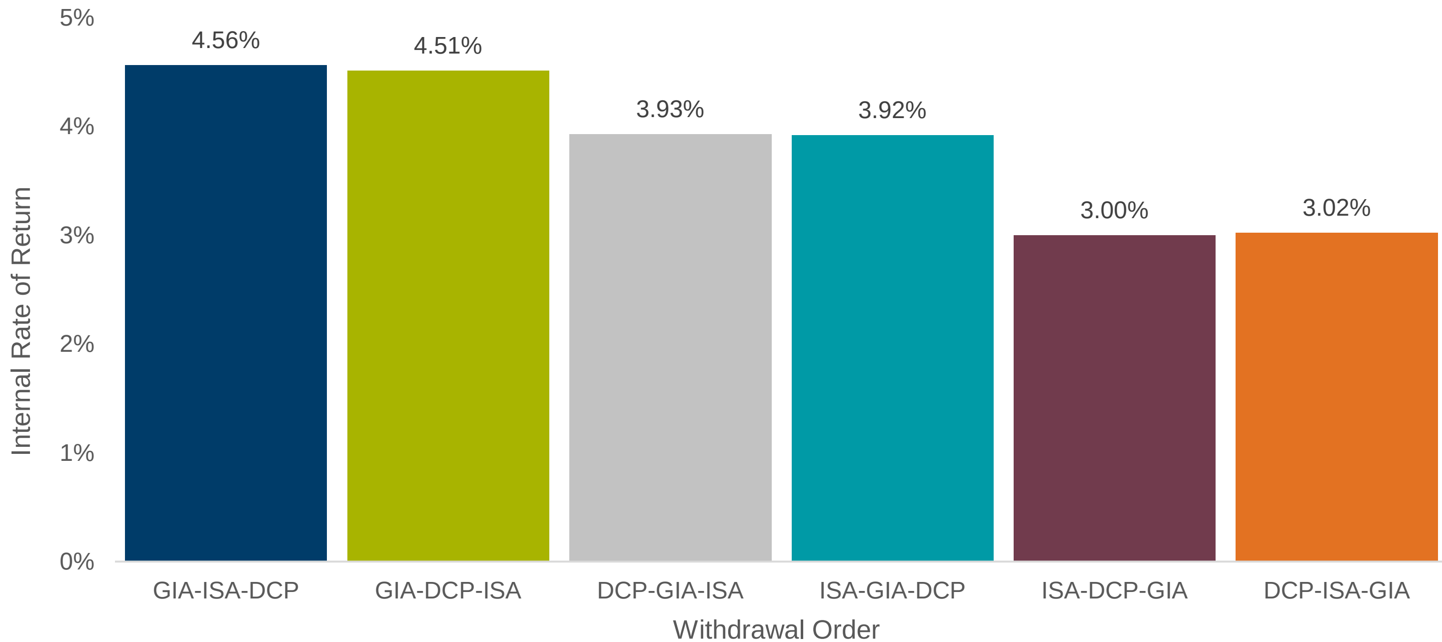
Adviser Alpha
Value
0 - 153 bps

- Spending strategies are worth 0 - 153 bps
- Bewildering discretion and choice…
- Spending from taxable assets or tax advantaged assets?
- What about Intergenerational wealth transfer?

6. Withdrawal order for client spending

Adviser Alpha Value
0 - 153 bps

Average IRR (internal rate of return) of different withdrawal-order strategies



Past performance is not a reliable indicator of future results.
Source: Vanguard, as at 30 November 2019. Notes: Account types denoted as follows: GIA – General Investment Account, DCP – Defined Contribution Pension, ISA – Individual Savings Account. Calculations based on funds of £1,200,000 (£400,000 in each account) and £58,000 after-tax spending with State Pension included. For our analysis, we assume the modelled portfolios hold a 50% stock/50% bond allocation in each of the tax wrappers, rebalanced annually and with an overweighted of approximately 15% to domestic holdings. Example shown for a higher rate tax payer with interest income tax of 40%, dividend income tax of 32.5% and capital gains tax up to 20%. Annual crystallisation method assumed. These hypothetical data do not represent the returns on any particular investment. Each internal rate of return (IRR) is calculated by running the same 10,000 VCMM path simulations for 50% equity, 50% fixed income instruments across 30 years. See Appendix for benchmarks used for VCMM calculations.

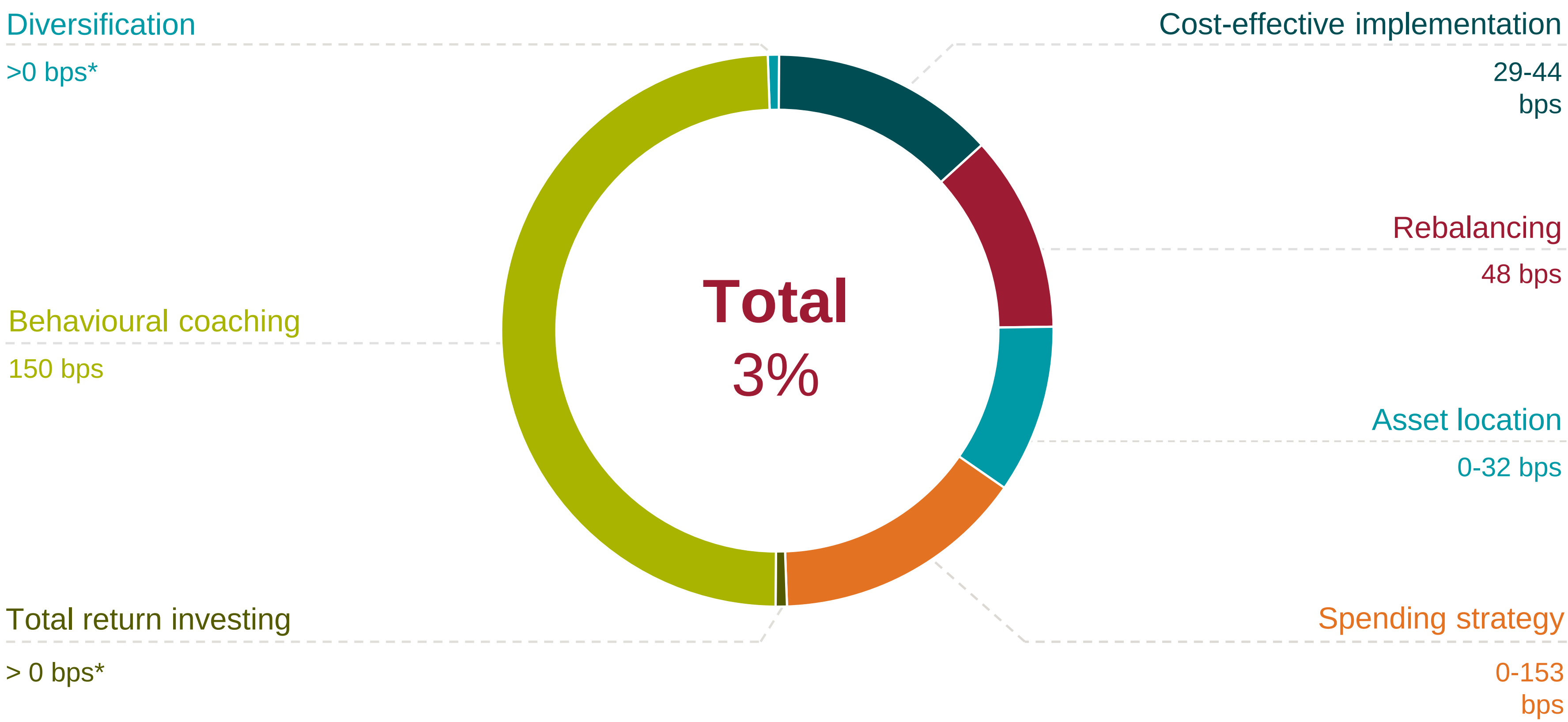
7. Total-return versus income investing

Adviser Alpha Value
>0 bps

Income-only strategy	**Impact on a portfolio (compared with capital-weighted portfolio at the sub-asset class level)**	
Overweight long-term bonds	Sensitivity to interest rate changes ↑	
Overweight credit bonds	Credit risk ↑	Downside protection ↓
Overweight dividend-centric equity	Concentration risk ↑	Tax efficiency diversification ↓

Source: Vanguard.

Adviser's Alpha framework



Source: Vanguard.

Good for clients. Good for your business.

Clients who think that their adviser adds significant value are:

1. More confident they will reach their goals

2. More loyal

3. More profitable

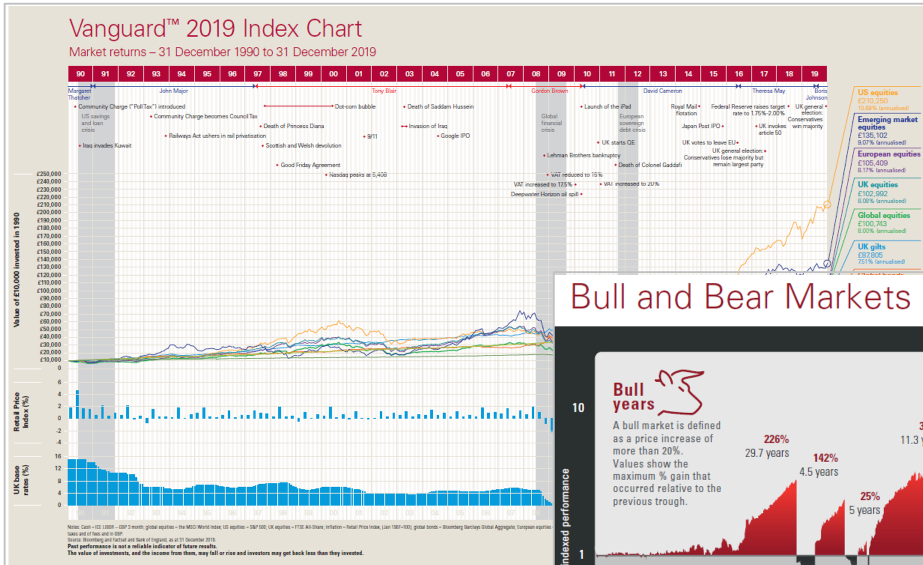
4. More likely to provide referrals

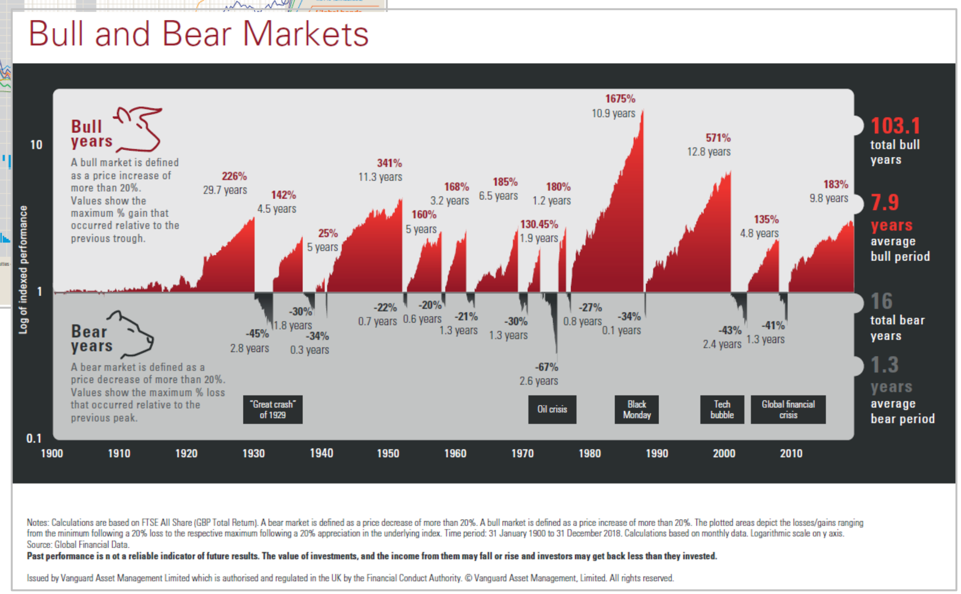
Source: Vanguard

“The definition of an expert is knowing when to bring one in”

Angie Staunton

Additional Vanguard collateral for behavioural coaching





Source: Vanguard.

Additional Vanguard collateral for the value of advice

Source: Vanguard.

Further Vanguard research

Source: Vanguard.

Question Time.....

Q&A

Appendix – benchmarks used for asset classes

- **UK equity**: Bloomberg Barclays Equity Gilt Study from 1900 to 1964, Thomson Reuters Datastream UK Market Index 1965 to 1969; MSCI UK thereafter.
- **Global ex UK equity**: S&P 90 Index from January 1926 to 3 March 1957; S&P 500 Index from 4 March 1957 to 1969; MSCI World ex UK from 1970 to 1987; MSCI AC World ex UK from 1988 onwards.
- **EM equities:** MSCI Emerging Markets Index.
- **UK bonds**: Bloomberg Barclays Sterling Aggregate Bond Index.
- **Global ex UK bonds**: Standard & Poor's High Grade Corporate Index from 1926 to 1968, Citigroup High Grade Index from 1969 to 1972, Lehman Brothers US Long Credit AA Index from 1973 to 1975, Bloomberg Barclays US Aggregate Bond Index from 1976 to 1990, Bloomberg Barclays Global Aggregate Index from 1990 to 2001; Bloomberg Barclays Global Aggregate ex GBP Index from 2001 onwards.
- **UK treasuries**: Bloomberg Barclays Sterling Gilt Index.
- **UK credit**: Bloomberg Barclays Sterling Non-Gilt Index.
- **UK cash**: Bloomberg Barclays Sterling 3-Month Gilt Index.
- **EM sovereign bond**: Bloomberg Barclays EM USD Aggregate Sovereign.
- **Global credit bond**: Bloomberg Barclays Global Aggregate Credit Index.
- **UK inflation**: Consumer Price indexes – RPI all items long-run series. Source: Office for National Statistics.

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The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Past performance is not a reliable indicator of future results.

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