

The Future of Advice

Communicating Adviser Value in a fee based world

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7th October 2021

This document is directed at professional investors and should not be distributed to, or relied upon by retail investors.
The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Vanguard

Agenda

Adviser landscape – importance of the adviser

Communicating fees to clients

Areas advisers add value over and above a DIY outcome?

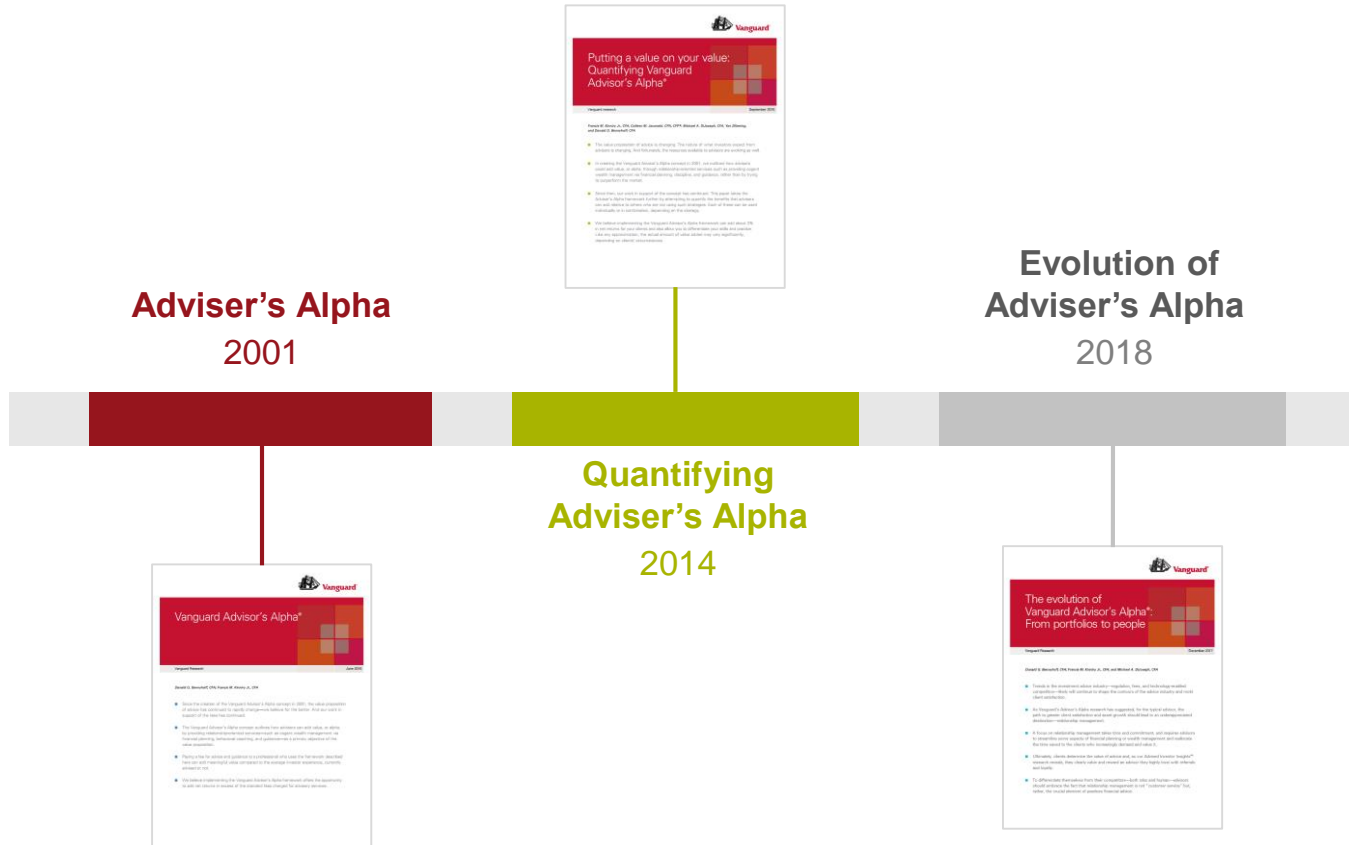
Behavioural coaching – key to unlocking client planning success

Q&A & next steps

“The adviser’s job is to help their clients
avoid making costly mistakes”

John C Bogle

Adviser's Alpha timeline

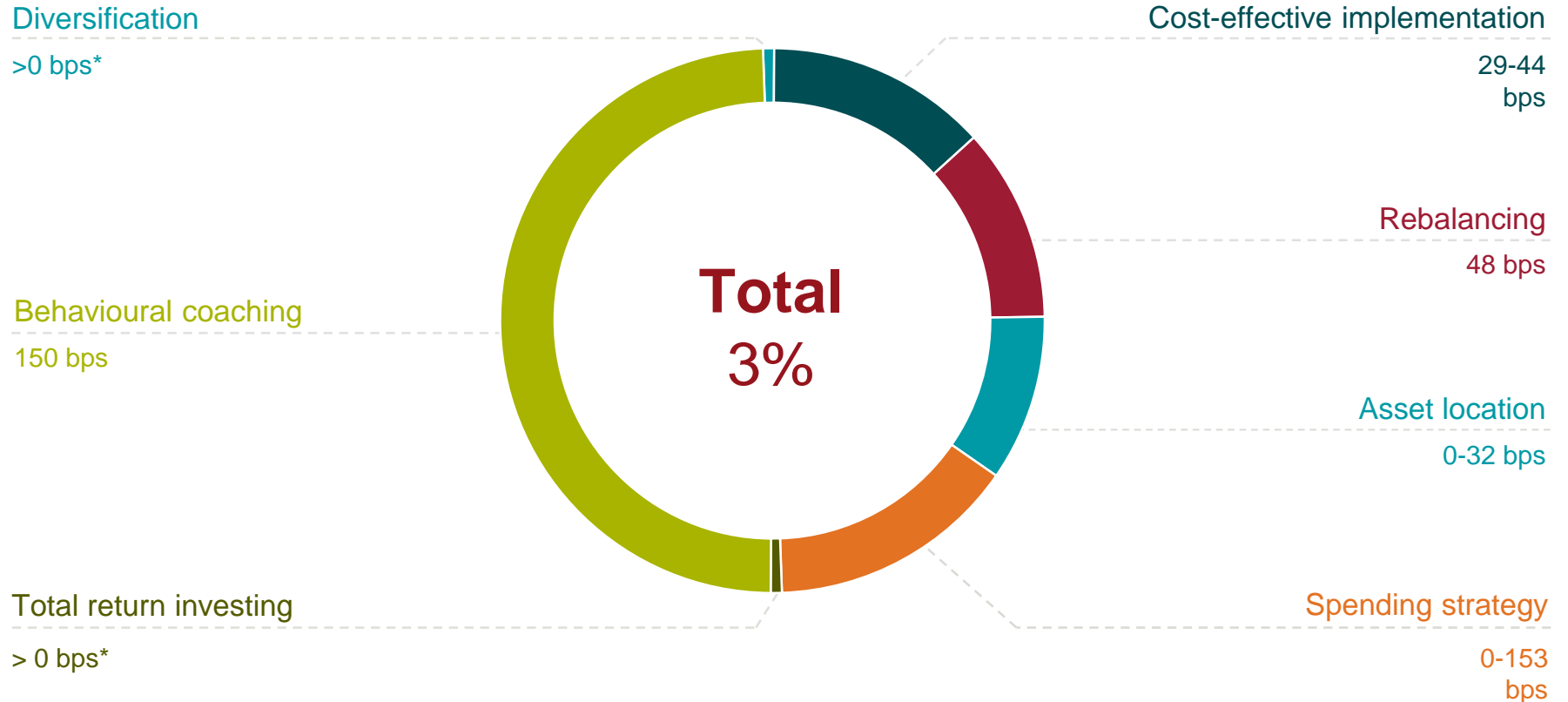


**Adviser's Alpha
2001**

**Evolution of
Adviser's Alpha
2018**

**Quantifying
Adviser's Alpha
2014**

Adviser's Alpha framework



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...

£64bn

£521bn

But the landscape is evolving...

Manufacturing
Fund

Administration
Platform

Distribution
Advice

2010

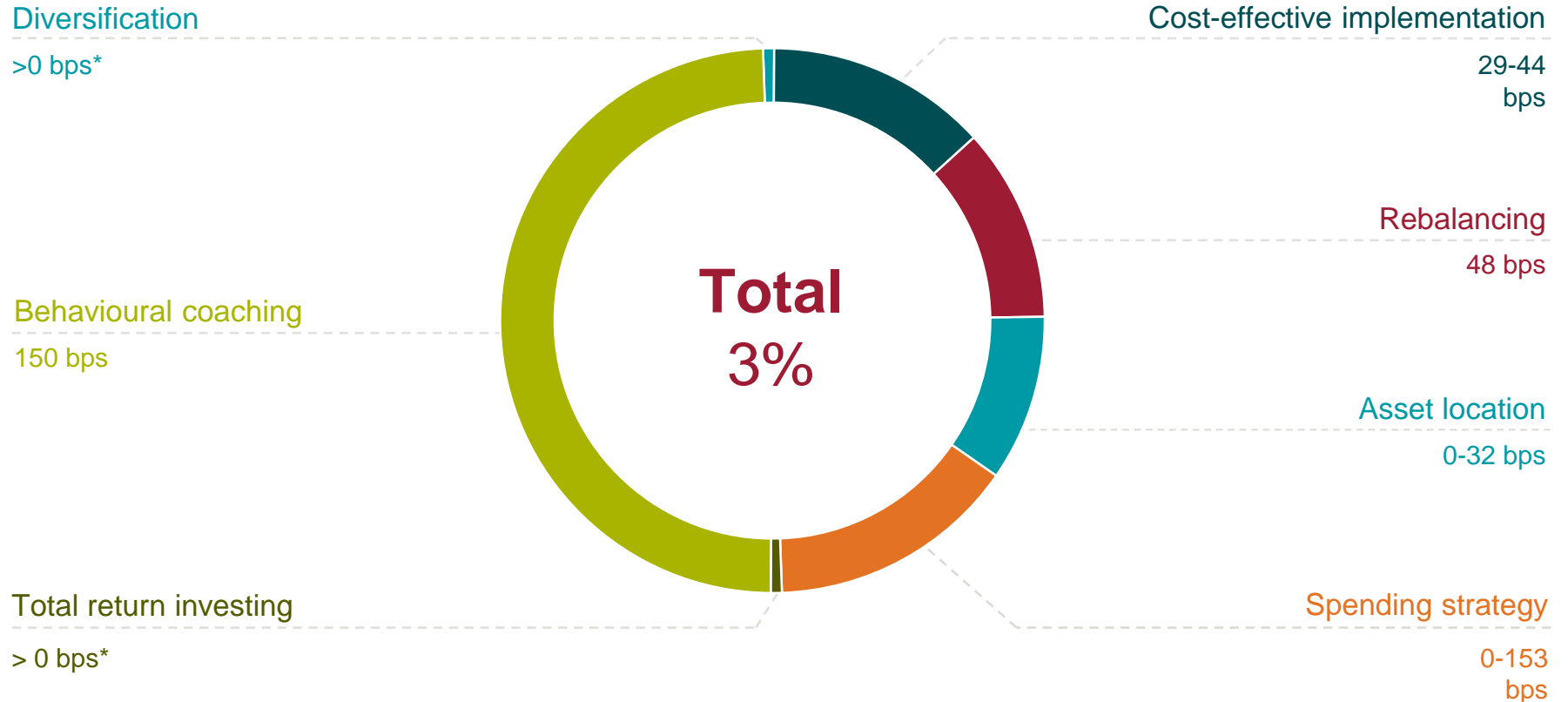
bps

2020

bps

Source: Vanguard

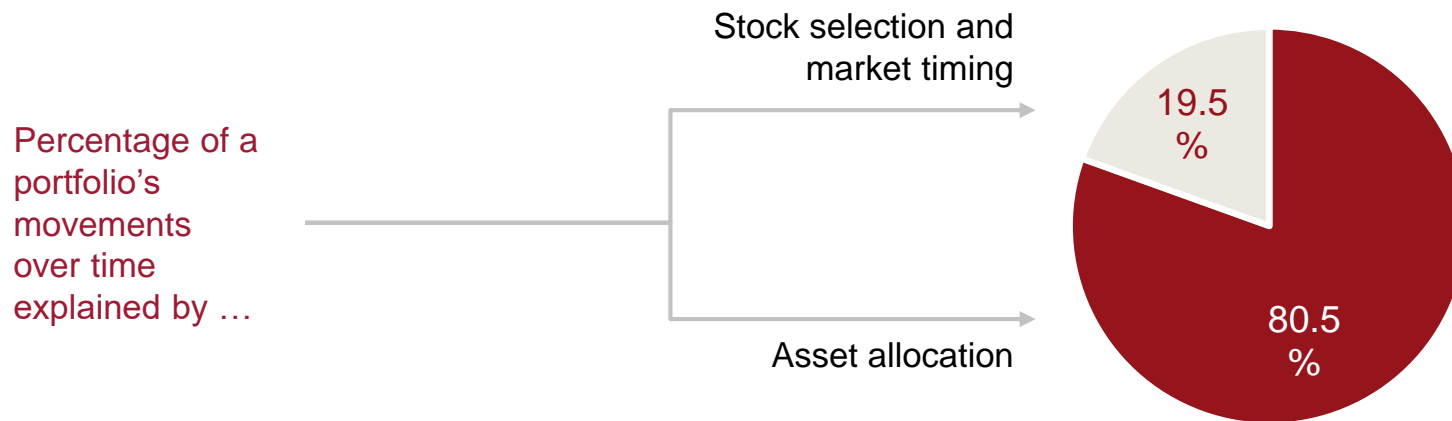
Adviser's Alpha framework



Asset allocation

1. Asset allocation

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

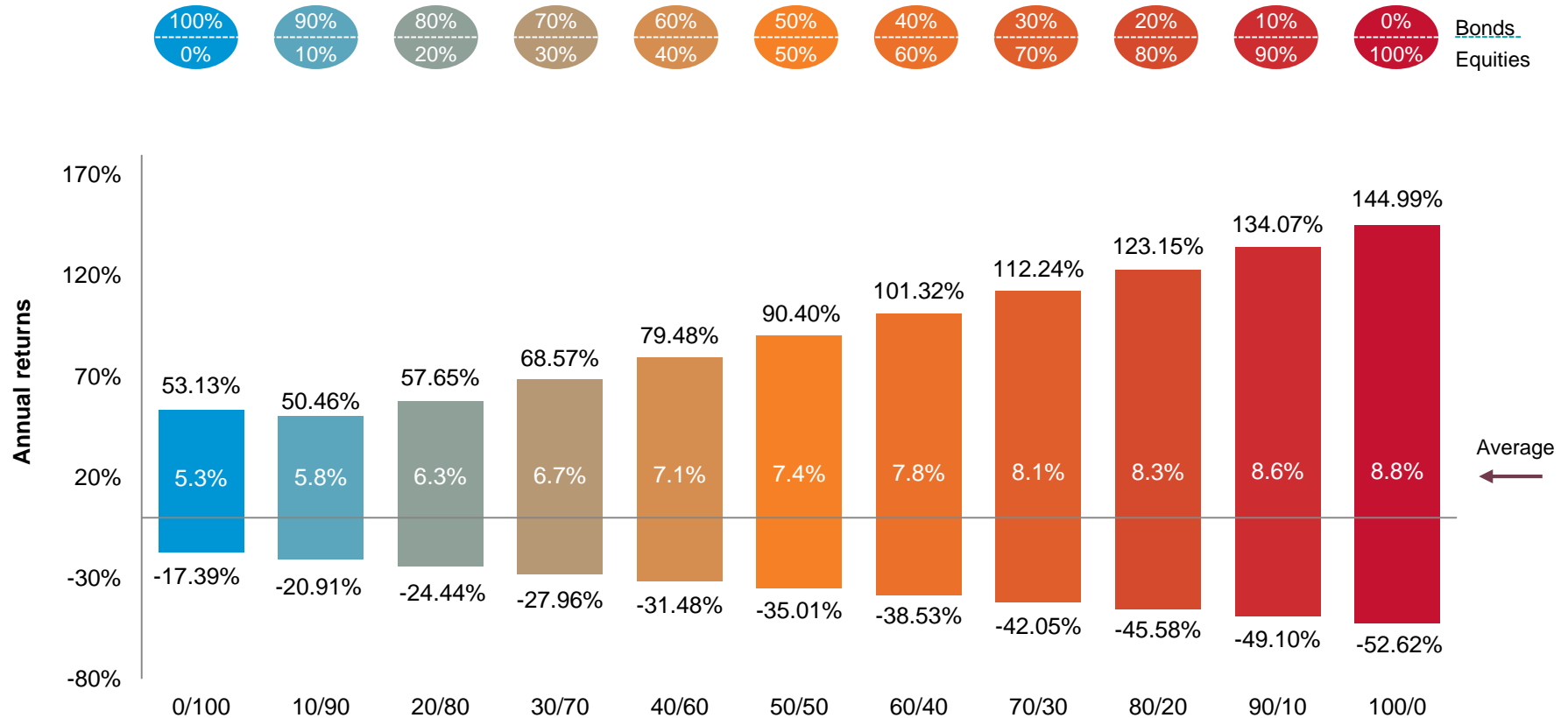


Source: Vanguard calculations using data from Morningstar.

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

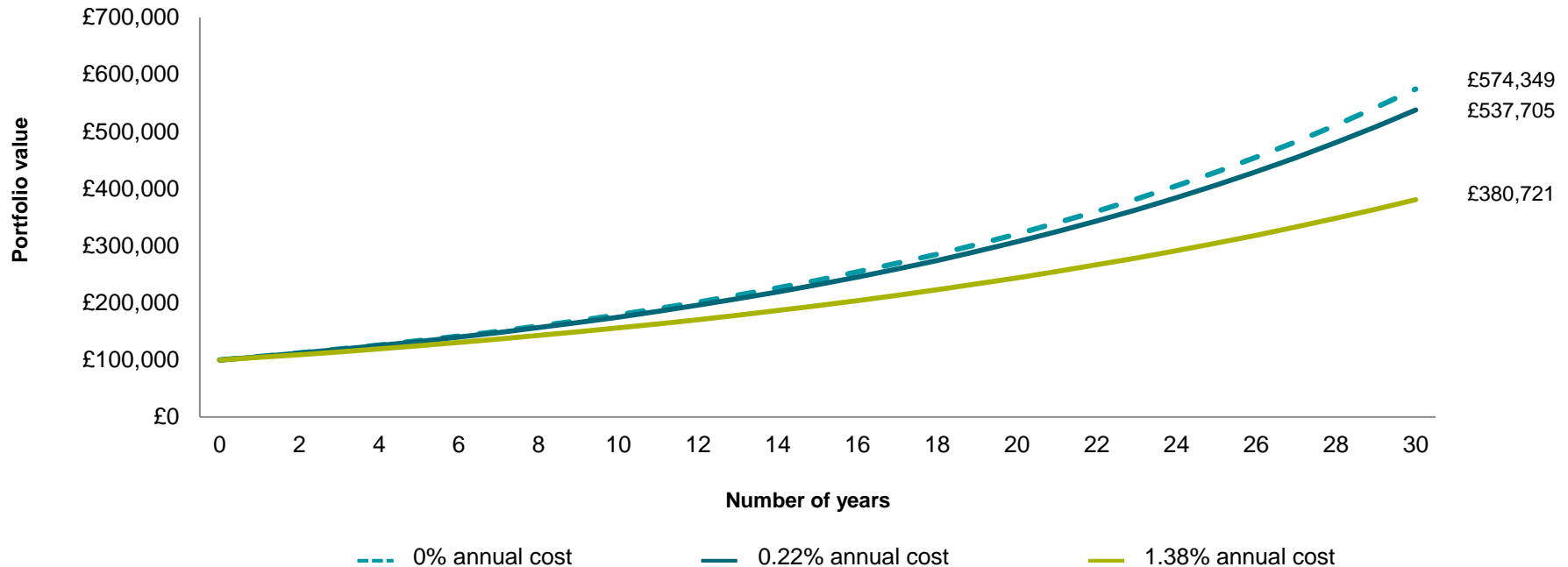
Equity/bond mix (%):	100/0	80/20	60/40	50/50	40/60	20/80	0/100
Asset-weighted expense ratio (AWER)	0.66	0.62	0.58	0.56	0.54	0.50	0.46
Quartile 1 AWER (Q1)	0.22	0.21	0.20	0.19	0.19	0.18	0.17
Cost-effective implementation (AWER vs. Q1)	0.44	0.41	0.38	0.36	0.35	0.32	0.29

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

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



Source: Vanguard

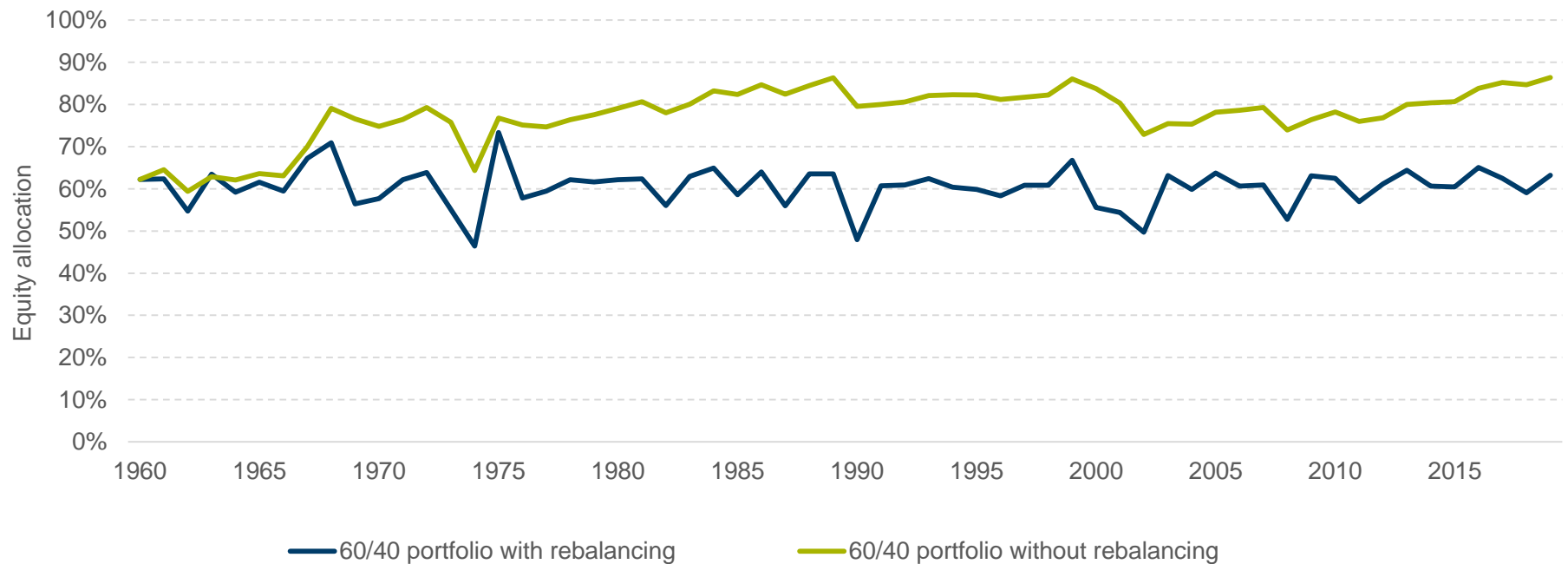
Note: The portfolio balances shown are hypothetical and do not reflect any particular investment. The final account balances do not reflect any taxes or penalties that might be due upon distribution.

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.

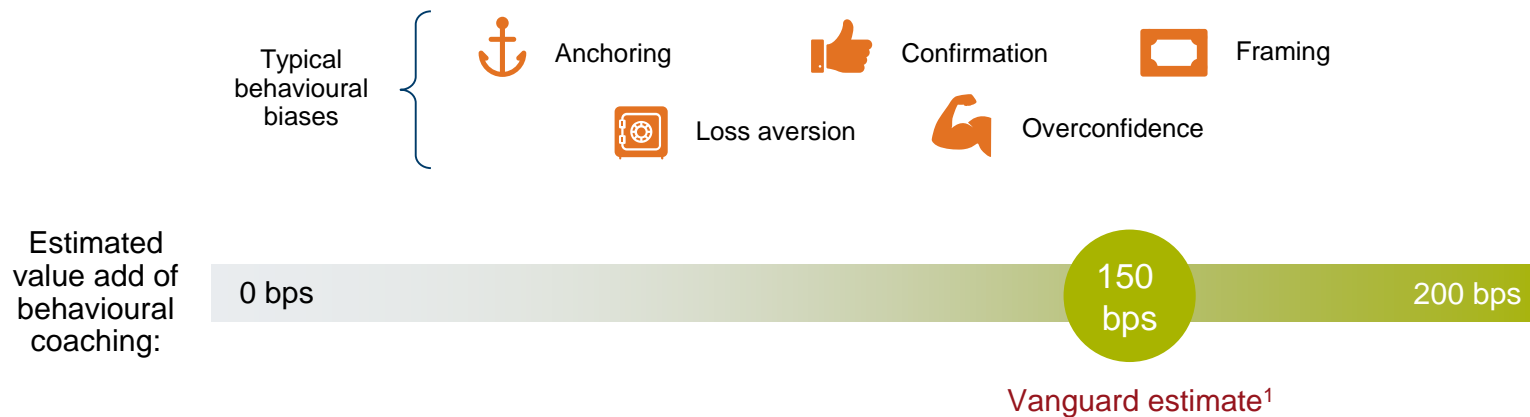
Notes: The initial allocation for both portfolios is 60% global equity and 40% global bonds. The rebalanced portfolio is returned to this allocation at the end of each June and December. Global equity is defined as the MSCI All Country World Investable Market Index, GBP un-hedged. Global bonds are defined 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

There is significant scope to improve returns by counteracting behavioural bias



Adviser Alpha
value
150 bps

- ✓ **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 150bps¹**

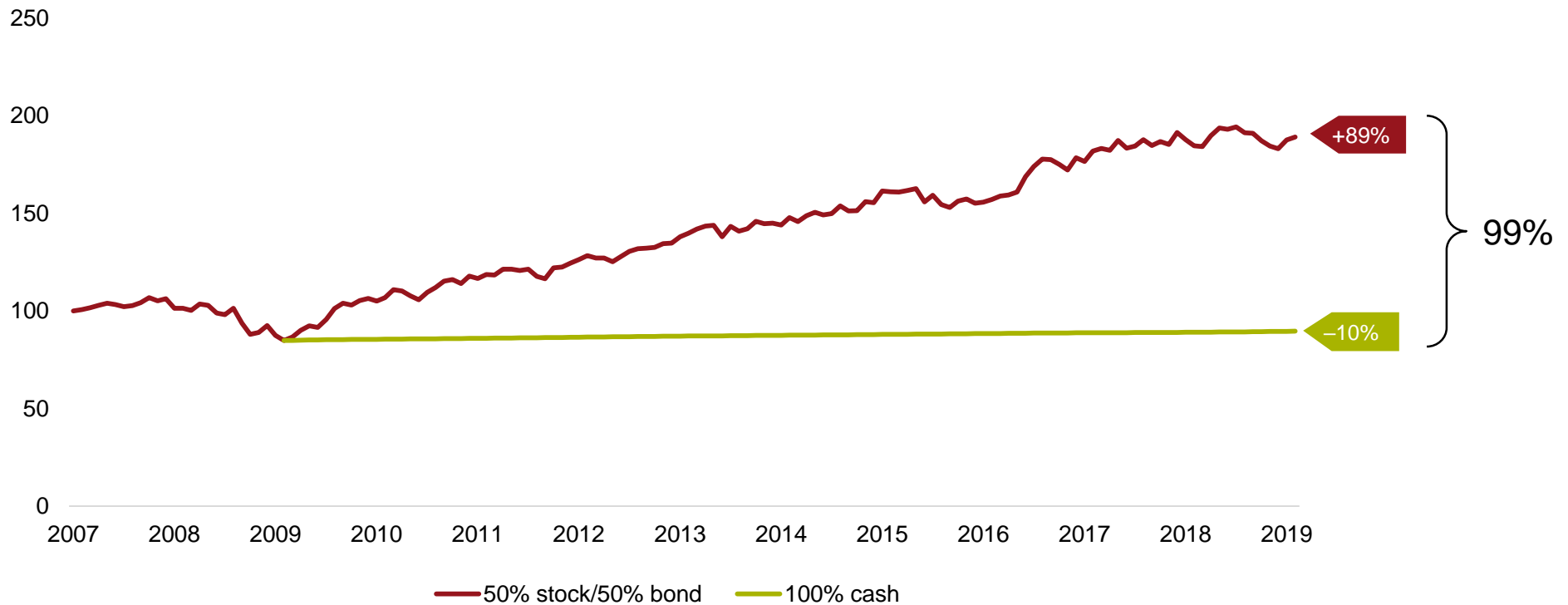
Source: Vanguard.

(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

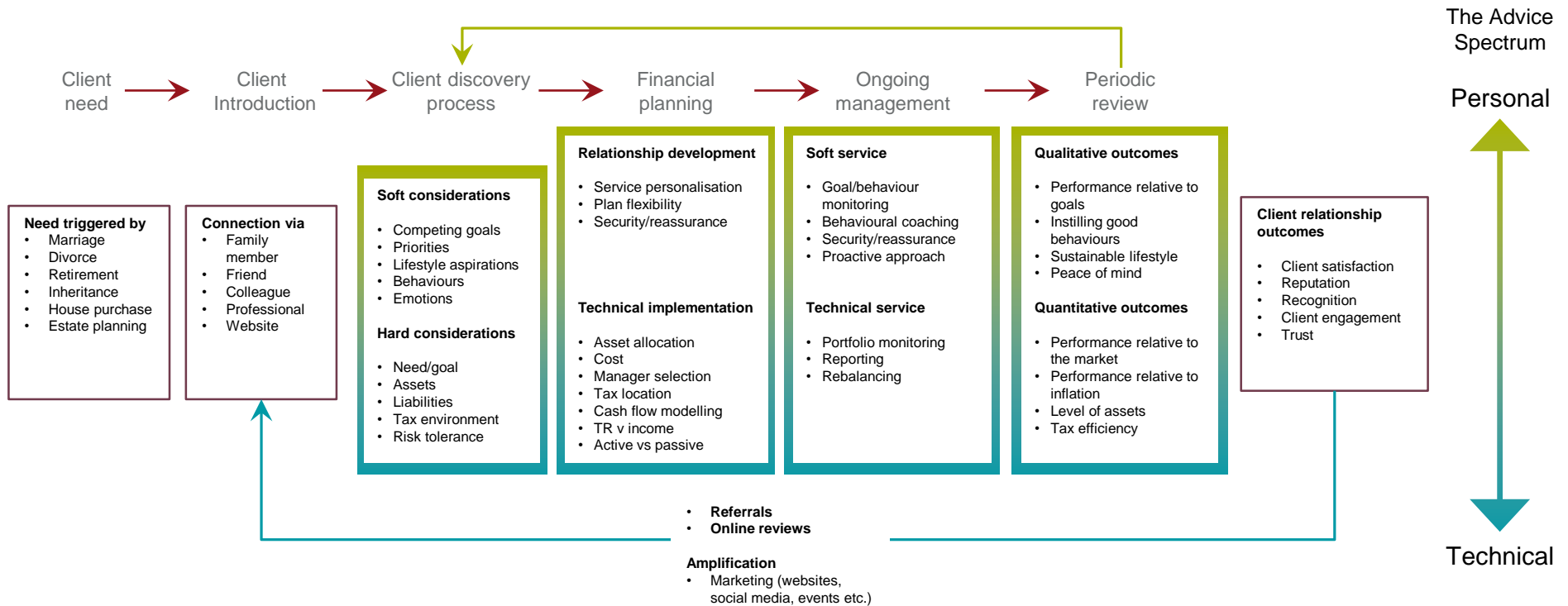
Value of a hypothetical £100 invested at the beginning of 2007



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

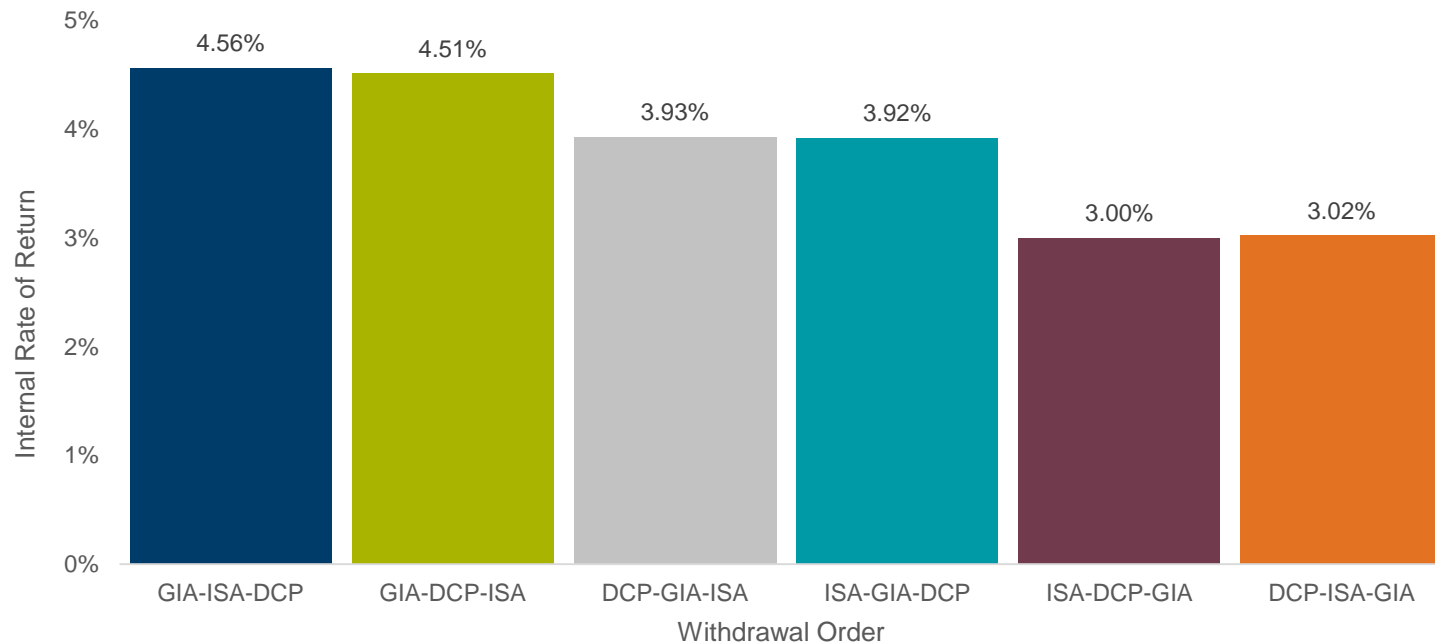
Adviser Alpha
Value
0 - 153 bps

- 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.

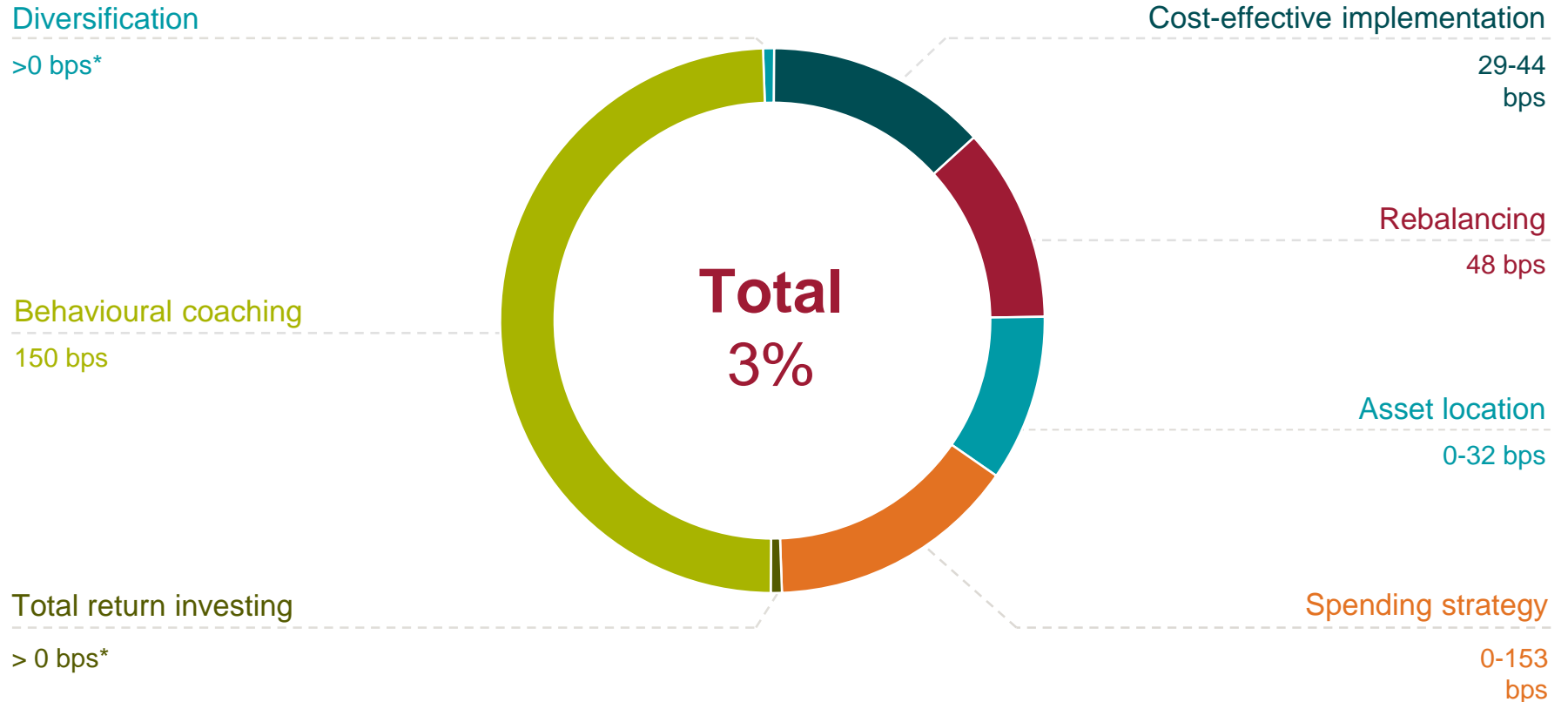
Source: Vanguard, as at 30 November 2019. Notes: Account types denoted as follows: GIA – General Investment Account, DCP – Defined Contribution Pension, ISA – Individual Savings Account. Calculations based on funds of £1,200,000 (£400,000 in each account) and £58,000 after-tax spending with State Pension 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 

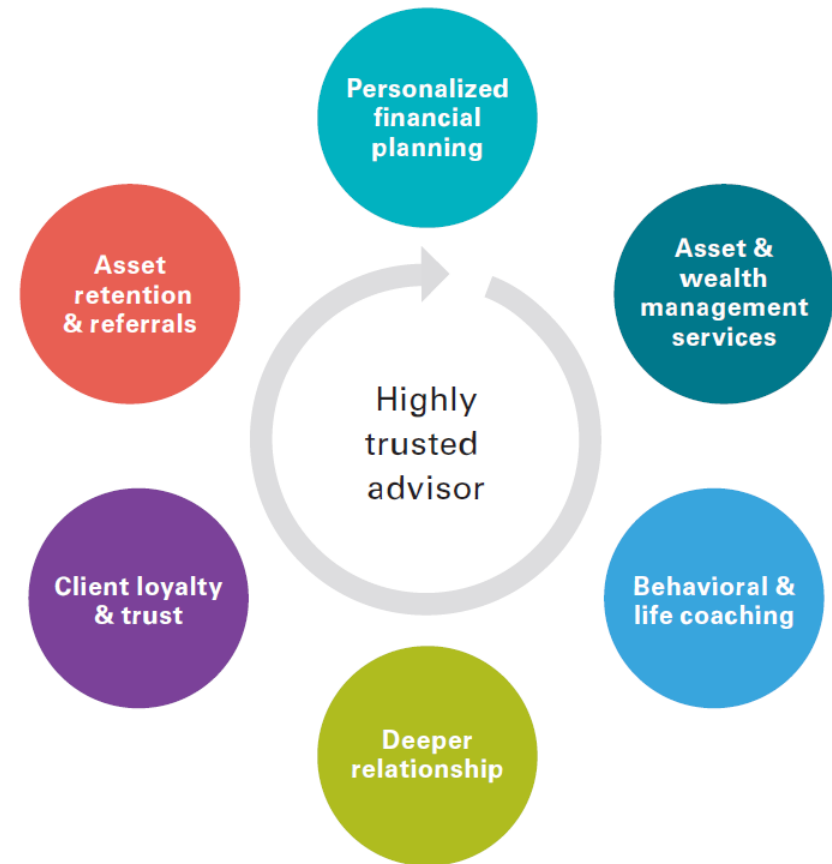
Adviser's Alpha framework



Good for clients. Good for your business.

Clients who think that their adviser adds significant value are:

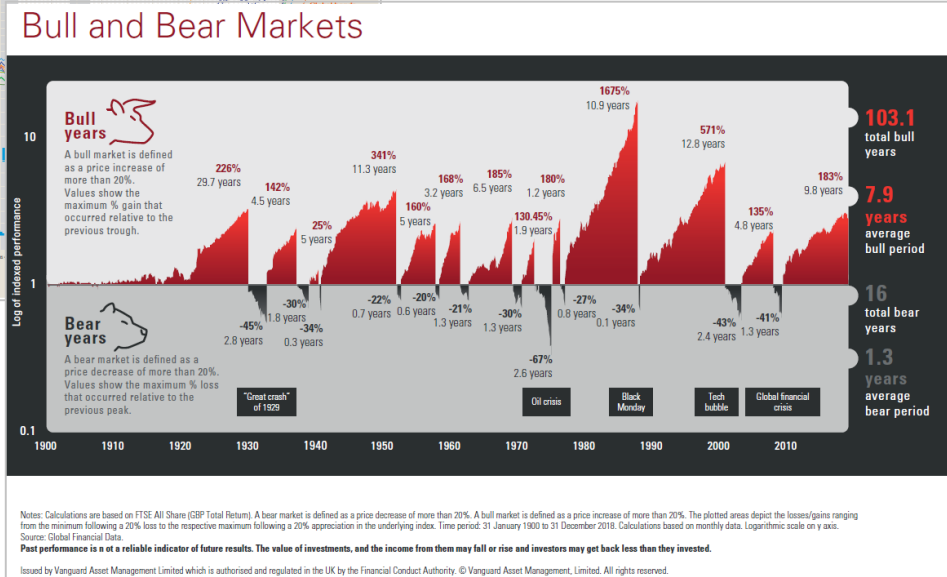
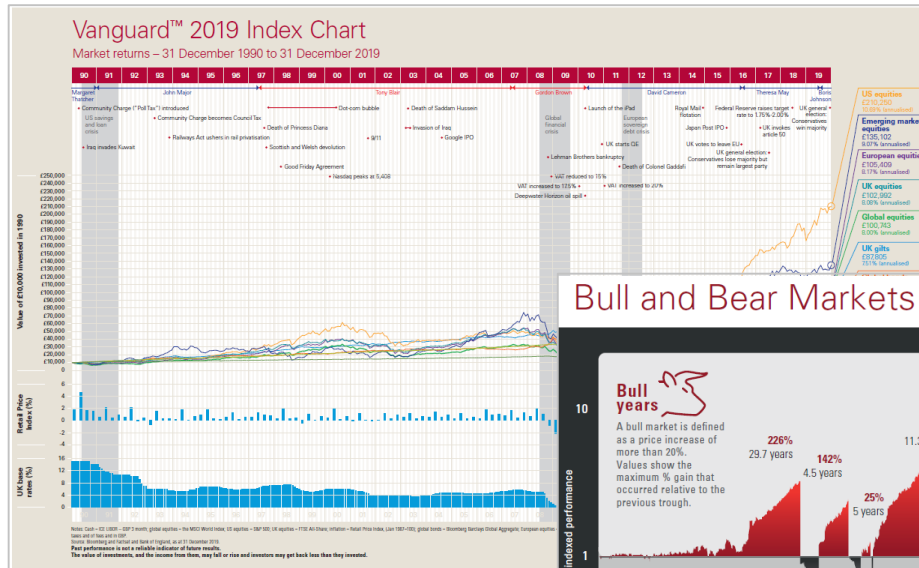
1. More confident they will reach their goals
2. More loyal
3. More profitable
4. More likely to provide referrals



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

Angie Staunton

Additional Vanguard collateral for behavioural coaching



Notes: Calculations are based on FTSE All Share (GBP Total Return). A bear market is defined as a price decrease of more than 20%. A bull market is defined as a price increase of more than 20%. The plotted areas depict the losses/gains ranging from the minimum following a 20% loss to the respective maximum following a 20% appreciation in the underlying index. Time period: 31 January 1900 to 31 December 2018. Calculations based on monthly data. Logarithmic scale on y axis. Source: Global Financial Data.

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Additional Vanguard collateral for the value of advice

The Advantage of Advice

Wherever you are on your wealth journey, your adviser can help you to achieve your goals.

Start your journey here →





What to look for in a financial adviser

At Vanguard, we believe that most people will improve their chances of investing success by using a financial adviser. We've done a lot of research into what makes great financial advice and we believe there are seven key things to look for.

- 1 Selecting the right mix of investments**

Should you invest in shares of companies or would you be better off with bonds, which are interest? Should you invest in the UK or abroad? The UK or Europe? Research shows that these big decisions will be the main drivers of your future returns as well as the size and where you are doing the work. Making the right choice – the right asset allocation, to use a technical term – is critical.

Good asset allocation doesn't seek to maximise returns. The art of asset allocation is to create a portfolio likely to fulfil your life goals, drawing on the different characteristics of shares, bonds and other investments.

Your adviser will help you build a portfolio that reflects your goals and your willingness to take risk to achieve them.
- 2 Keeping your portfolio on track**

Different types of investments perform differently over time, which means that your initial asset allocation will tend to drift away from the target you agreed on first. Meanwhile, higher risk assets will tend to outperform in the medium to longer term, slowing the risk profile of your portfolio.

Your adviser can help you to put a regular, disciplined rebalancing programme in place to keep your portfolio aligned with your goals.
- 3 Helping you keep more of your returns**

Fund costs can vary widely. What's more, the impact of costs compounds over time, eating into your returns. For example, on a static £10 investment, with an annual charge of 2%, you'll end up with 10% less in 10 years. With an annual charge of 0.2%, over 96% of the fund will remain in 10 years. That's a big difference.

Unlike other asset classes, when you invest, costs are payable, not necessarily better. Research shows that lower-cost funds are more likely to outperform in the longer term. That's why we see that in the world of investing, you get what you don't say for.

Your adviser will help you by selecting high-quality, low-cost funds for your portfolio.
- 4 Acting as your behavioural coach**

One of the biggest reasons why you do not achieve your financial goals is to take advantage of good times. "Make hay while the sun shines" is a financial proverb, but it doesn't always apply. In fact, investment best practice is the opposite of making hay while the sun shines. It's to buy low and sell high.

Research shows that, left to their own devices, investors often travel in the wrong direction, selling when they should be buying and buying when they should be selling. That's because they are subject to well-known behavioural biases such as over-confidence and loss aversion.

When the going gets tough – or markets get over-enthusiastic – your adviser will help you to tune out the noise and stay focused on your long-term goals.
- 5 Making the most of your tax allowances**

Just like other costs, tax is a charge that will compound over time, reducing your returns. Tax efficiency is a critical support of good investment outcomes.

The UK offers a number of tax-efficient investment vehicles, including Individual Savings Accounts (ISAs) and Self-Invested Personal Pensions (SIPPs). You can also take advantage of the tax differences between income paid by shares and bonds.

A good adviser will help maximise your returns by structuring your portfolio to minimise tax.
- 6 Setting the most efficient spending strategy**

Drawdown strategies – in other words, the way in which you spend the money you've earned – are becoming increasingly important. That's because the most tax-efficient way of drawing income from capital while preserving the growth potential of the remaining portfolio.

Your adviser can help you construct a total return approach that helps you to control risk by avoiding the need for higher risk, higher yielding assets.
- 7 Helping you to look beyond income to total return**

In a world of low interest rates, when it comes to spending from your portfolio you have three options. You can spend less; you can move into higher yielding investments; or you can spend more. Or you can spend from 'total return', which includes both capital and income.

Your adviser can help you construct a total return approach that helps you to control risk by avoiding the need for higher risk, higher yielding assets.

The Advantage of Advice

A guide to how your adviser helps you secure your financial future



Further Vanguard research

The evolution of Vanguard Advisor's Alpha™: From portfolios to people

Vanguard Research

Donald G. Benneyhoff, CFA; Francis M. Kliney, Jr., CFA; and Michael A. DuJoseph, CFP

- Trends in the investment advice industry—regulation, fees, and tech competition—likely will continue to shape the contours of the advice client satisfaction.
- As Vanguard's Advisor's Alpha research has suggested, for the typical path to greater client satisfaction and asset growth should lead to a destination—relationship management.
- A focus on relationship management takes time and commitment, and to streamline some aspects of financial planning or wealth management the time saved to the clients who increasingly demand and value it.
- Ultimately, clients determine the value of advice and, as our Advisor's Alpha research reveals, they clearly value and reward an advisor they high and loyalty.
- To differentiate themselves from their competitors—both robo and human—advisors should embrace the fact that relationship management is not "custodial" but rather, the crucial element of peerless financial advice.

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The Vanguard Adviser's Alpha® guide to proactive behavioural coaching

Vanguard Research

Donald G. Benneyhoff, CFA

- Investing is an emotionally charged effort that challenges people to cope with uncertainty and doubt.
- With behavioural coaching, and by keeping the focus on the "3 Ps" discussed herein—planning, proactivity, and positivity—advisors can add considerable value to their client relationships.
- The future is uncertain for everyone. Often, it's how people—both clients and advisers—deal with this uncertainty that leads to better, mutually beneficial outcomes.

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The value of advice: Assessing the role of emotions

Vanguard Research

March 2020

Anna Madamba, Ph.D., Cynthia A. Pagliaro, and Stephen P. Utkus

- Emotional value, one of the three major components of our value of advice framework, is in many ways the most challenging component to measure. Using a survey of both traditionally advised investors and investors who use a robo-advisor service, we show that emotional value is a significant component of the perceived value of financial advice.
- For those investors assigning the highest value rating to their advisory relationship, around 40% of the incremental value is associated with emotional elements such as trust and personal connection with the advisor or advisory service.
- When assessing the value of advice, traditionally advised investors tend to do so through the lens of their relationship with their financial advisor. Robo-advised investors, on the other hand, highlight their need for transparency and empowerment when assessing the value of their advice service.
- Ascertaining the "value-for-money" trade-off made by investors is difficult, as we found that most do not have a clear understanding of the price they pay for financial advice.
- Our research has quantified the role of emotions in the advisory relationship. We believe that, going forward, assessments of the value of financial advice should include an evaluation of the emotional value it provides investors.

Acknowledgements: We would like to thank Christa Meloni and Jennifer Trujillo of Vanguard's Center for Analytics and Insights for their help with the survey logistics.

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.

Important information

IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. VCMM results will vary with each use and over time.

The VCMM projections are based on a statistical analysis of historical data. Future returns may behave differently from the historical patterns captured in the VCMM. More important, the VCMM may be underestimating extreme negative scenarios unobserved in the historical period on which the model estimation is based.

The Vanguard Capital Markets Model® is a proprietary financial simulation tool developed and maintained by Vanguard's primary investment research and advice teams. The model forecasts distributions of future returns for a wide array of broad asset classes. Those asset classes include US and international equity markets, several maturities of the U.S. Treasury and corporate fixed income markets, international fixed income markets, US money markets, commodities, and certain alternative investment strategies. The theoretical and empirical foundation for the Vanguard Capital Markets Model is that the returns of various asset classes reflect the compensation investors require for bearing different types of systematic risk (beta). At the core of the model are estimates of the dynamic statistical relationship between risk factors and asset returns, obtained from statistical analysis based on available monthly financial and economic data from as early as 1960. Using a system of estimated equations, the model then applies a Monte Carlo simulation method to project the estimated interrelationships among risk factors and asset classes as well as uncertainty and randomness over time. The model generates a large set of simulated outcomes for each asset class over several time horizons. Forecasts are obtained by computing measures of central tendency in these simulations. Results produced by the tool will vary with each use and over time.

Investment Risk

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

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For further information on risks please see the “Risk Factors” section of the prospectus on our website at <https://global.vanguard.com>.

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