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Advisor's Alpha Part 1

By: Zach T. Horn, CFP®

A 2014 Vanguard study attempts to estimate the value proposition of using an advisor with best practices in wealth management and terms these value-adds collectively as "Advisor's Alpha". The value of working with an advisor is subjective, individual to each investor, and challenging to quantify. Vanguard's framework is a helpful attempt to clarify the potential for added value and to provide a basic measurement. Not all of the strategies are applicable to every investor, and value will vary based on individual client circumstances as well as the implementation by the advisor.

According to the study, working with an advisor can potentially add up to **"about 3%"** of net return annually (in addition to the unquantifiable value of peace of mind which may come from working with an advisor). That estimate sounds generous to us, but it does bring attention to the advantages of working with an advisor that investors may not consider when deciding whether to seek advice or opt for a Do-It-Yourself approach.

Strategies that add value include: *Asset Allocation, Cost Effective Implementation, Rebalancing, Behavioral Coaching (adhering to a plan), Asset Location, Spending Strategy (withdrawal order), and Total-Return Investing*.

Vanguard quantifies the value-add of best practices in wealth management -Value-add relative to "average" investor experience	
I. Suitable asset allocation	> 0%
II. Cost-effective implementation	~ 0.45%
III. Rebalancing	~ 0.35%
IV. Behavioral coaching	~ 1.50%
V. Asset location	~ 0% to 0.75%
VI. Spending strategy (withdrawal order)	~ 0% to 0.70%
VII. Total-return investing	> 0%
Potential Value Added	"About 3%"

Notes: Return value-add for Modules I and VI was deemed significant but too unique for each investor to quantify.

Also, for "Potential value added," we did not sum the values because there can be interactions between the strategies.

Source: Vanguard

Let's discuss the first two strategies:

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Advisor's Alpha Part 1

I. Suitable Asset Allocation

Asset allocation is the most important determinant of portfolio risk and long-term returns. It is imperative that investors have an appropriate asset allocation of broadly diversified investments that aligns with their goals and future needs. A sound investment plan should begin with an Investment Policy Statement that defines targets for asset allocation based on an investor's financial objectives, risk tolerance, investment time horizon, tax considerations, and distribution needs. This is the foundation that an appropriate portfolio is built upon to lead to investing success. The value gained from an appropriate asset allocation is positive yet difficult to quantify. Advisors should take a considerable amount of time to understand their client's current financial situation as well as future goals and, through a collaboration of financial planning and investment management, set appropriate targets to allow for growth and income to meet a client's long-term needs.

II. Cost Effective Implementation

Simple math tells us that gross return minus costs equals net return. Those costs can come from management fees, expense ratios, trading costs, and taxes. Advisors can certainly add value but that value is greater when management fees are reasonable for the services provided. When appropriate, costs can be minimized by using funds with low expense ratios or, better yet, investing in individual stocks and bonds (with even lower costs than index funds), and limiting turnover. For asset classes where mutual funds are used, advisors can have access to share classes of funds that have no load fees and lower expense ratios than share classes offered to retail investors. Some entire fund families are only available to select advisors. Funds that have relatively high costs should only be used when they are unique strategies that have the potential to provide significant value and a low cost alternative is not available. Trading costs from the custodian of your accounts should be negotiated to a minimal amount by your advisor. Tax-efficient investing is an often overlooked way to reduce costs. In taxable accounts, limiting realized capital gains and harvesting losses during market declines allows for less of a tax burden on the portfolio. A good advisor will evaluate investments based on net return expectations and focus on maintaining a well-diversified portfolio in balance with an appropriate asset allocation while keeping costs low.

Part 2 of this series will focus on *Rebalancing, Behavioral Coaching and Asset Location*.

Travel Insurance: What Do You Need?

BY: Emilie Geiler, CPA

As the weather turns from winter to spring many of us are thinking ahead to our vacations for the year. Travel insurance is regularly offered as an option before you book your trip, but do you need it? Business travelers may also wonder if they are protected or need insurance. Who actually needs travel insurance? It depends. Travel insurance offers financial protection from potentially expensive situations arising while traveling. Popular policy types offer coverage for a medical emergency or protect your investment in a trip.

If you are traveling out of the country, consider buying medical and evacuation protection, especially if you are going to a destination that lacks a well-developed hospital system.

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- **Health Insurance** - It may surprise you to learn that many health insurance policies don't cover medical expenses incurred outside the U.S. If you end up needing treatment, you may have to pay out of pocket. Medicare, for instance, generally does not cover such costs.

- **Evacuation Insurance** - If you have to be airlifted quickly from a remote location and transported to the U.S., the associated costs can be astronomical. Consider purchasing a policy that includes evacuation coverage if you plan on traveling to a country where you wouldn't feel comfortable receiving emergency treatment.

Another form of travel insurance protects your investment in the trip if you need to cancel. Many times these policies make sense to buy when you are paying a large sum of money upfront. There are three main types:

- **Trip Cancelation** - These policies offer reimbursement of travel expenses if something happens and you cannot go. Some policies are very flexible and allow you to cancel your trip for any reason, including extending coverage to problems encountered by your spouse or traveling companion. Others are more restrictive and only permit cancelation for specific situations.

- **Trip Interruption** - These policies offer reimbursement if something unexpected happens during a trip forcing you to leave early. For example, if you break your leg during a European tour and need to come home, you would be reimbursed for the part of the trip you missed.

- **Trip Delay** - These policies offer reimbursement for two types of events: delay in the start of your trip or a delay during your trip. For example, if you miss your flight and need to reschedule, the policy will cover the rescheduling costs. If you or a member of your party is delayed due to illness or injury, the policy may also cover rescheduling fees during the trip.

Trip coverage is included as part of a comprehensive plan. Many comprehensive travel insurance policies also cover the loss of baggage, theft, and damage to a rental car. Stand-alone medical and evacuation policies are available if you do not want to pay for a comprehensive plan but do want health coverage.

The timing of your purchase of travel insurance can affect the coverage of the policy. Some preexisting conditions may be covered by trip, evacuation, and health insurance if they are not an active problem at the time you book. If you need to receive treatment for a condition between when you book the trip and when you buy the policy, some companies will no longer cover the condition. Trip cancelation due to weather or bankruptcy by hotels, airlines, cruise lines, or hotels may be excluded if the policy is bought after the fact. For weather cancelations, if the storm is far enough along to have been named before you buy insurance it is not covered as a reason to cancel. For bankruptcy cancelations, the policy must be purchased before the public is notified that the company is a default risk.

Make sure you have a good understanding of your current insurance policies to reduce overlapping coverage. Some homeowners, auto, health, Medigap, and life insurance policies cover travel items, and some credit cards offer trip cancelation coverage. Travel insurance can be purchased annually or per trip. For people who travel often, annual coverage may be more attractive, but

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generally is limited to medical and evacuation policies. If you actively work with an insurance agent, they may be able to help you reduce overlap with your current policies.

Be sure to shop around as prices and coverage can vary greatly. The insurance offered by a travel agent or tour company may not be the best for you. Comparison sites like **www.insuremytrip.com** and **www.quaremouth.com** allow you to enter your trip details and compare different travel policies. These sites also have explanations of travel insurance and coverage details as well as travel tips. If you are a Rick Steves fan, he also covers the topic on his website ricksteves.com in his travel tips section.

As with any financial decision, some research is needed. Please feel free to contact your Foster & Motley advisor if you have any questions.

Employee Spotlight—Congratulations Emilie!

We are pleased to announce that **Emilie Geiler** was recently awarded her CPA designation. To earn this designation Emilie passed four exams with a score of 75 or better, obtained a year's experience under the supervision of another CPA, and successfully passed an ethics course. Way to go Emilie!

Department of Labor Fiduciary Rule

BY: Larry Bernhard, IACCP®

Recently, the Department of Labor (DOL) announced a new rule that will affect how financial advisors assist clients with their retirement accounts. The new regulation, commonly called the "fiduciary rule" or "the conflict of interest rule", requires all those providing investment advice to retirement account clients to work in the best financial interest of those clients and disclose any conflicts of interest. Financial service providers must be "fiduciaries", meaning they put clients' interests first, recommending the best-possible and most cost-effective retirement vehicles and advice.

Foster & Motley, as a Registered Investment Advisor with the Securities and Exchange Commission (SEC), has always operated under a similar fiduciary standard set by the SEC. Brokers, on the other hand, have operated under a less-rigid "suitability" standard, meaning investments merely needed to be suitable for clients. Under the new rule, brokers will be restricted in their recommendations of investments that pay them large commissions.

The DOL's standard pertains only to retirement account clients, while the SEC's standard applies to all clients. These two fiduciary standards are similar in spirit, yet they come from two very separate agencies operating in different contexts. Foster & Motley is bound by both the SEC and the DOL, and even though these agencies lack a unified standard, we will continue to perform our fiduciary duty for all clients, to ensure their interests come first.

It's unclear how the DOL will enforce this rule, or whether Congress will try to make changes to it. Because the rule was created to protect retirement account clients from conflicting and costly advice, continued debate is expected from brokers, as well as insurance companies, due to the commission-based retirement products many of them offer. The rule goes fully into effect January 2018. We will continue to monitor the rule and plan for its implementation.