



Setting the global standard for investment professionals

Managing Your Adviser Relationship

If words of command are not clear and distinct, if orders are not thoroughly understood, the general is to blame. But if his orders are clear, and the soldiers nevertheless disobey, then it is the fault of their officers. Sun Tzu (544 BC–496 BC)

The Chinese philosopher Sun Tzu is famous for analyzing a military situation in a way that allowed a weak king to defeat a competing power. Consider the markets and your financial challenges as a potentially superior force. You need to build alliances that will allow you to prevail in the face of portfolio setbacks and unexpected personal developments.

If you choose to use a financial adviser, be clear with your adviser (and yourself) about your goals and tolerance for loss. Managing your alliance with a financial adviser effectively can be imperative to conquering financial challenges.

One of the most important issues to consider when hiring a financial adviser is the type of relationship you hope to establish. You will typically want a professional with full knowledge of your financial, and even personal, situation. The long-term success of your affiliation relies on open, two-way communication built on a foundation of trust.

Gathering the Facts

Your adviser should ask you questions about your entire financial position. You should provide all the information necessary to manage your account, including full disclosure of financial assets, income streams, and liabilities (significant one-time and recurring obligations). Doing so helps your adviser understand the elements that affect your financial goals.

COMPENSATION TYPES

Investors pay their advisers in the following ways:

- Fees: Often “fee only”; investors pay for the adviser’s time, usually calculated as a percentage of assets or on an hourly basis.
- Commission: The adviser is paid for executing trades.

Although circumstances may dictate one type of payment or another, investors should always understand how they are paying for investment services.

FIDUCIARY

Fiduciaries are professionals who have a legal or ethical responsibility to consider your interests before their own or their employer’s. A Chartered Financial Analyst® (CFA®) wealth manager is such a professional.

Issues to discuss with your adviser include:

1. Will the adviser handle all of your assets or only a portion of them?
2. Are you disclosing all of your assets? Not only cash, stocks, and bonds but also other investments, such as equity positions in family businesses, real estate holdings, private partnership interests, and loans you may have made.
3. Which assets are designated for retirement, education, wealth transfer, or other specific needs? When will you need the assets?
4. What are your income requirements now and over time?

You and your adviser should also discuss these broad investment issues:

1. What does risk mean to you, and what is your risk tolerance level? What are your investment constraints?
2. What return do you hope to achieve?
3. What are the consequences of failing to achieve your investment objectives?
4. What is your tax situation? Do you have any special tax circumstances?
5. Should your investment portfolio reflect any social responsibility considerations?

Armed with the facts, a financial adviser should then provide you with a customized plan called an “investment policy statement” (IPS).

The Investment Policy Statement

You and your adviser will create, for your specific needs, a financial plan that can be adjusted to changes in your circumstances. An IPS is a document that sets out your objectives, tolerance for risk, investment constraints, and special needs as well as guidelines you wish to establish for investing your assets. The IPS serves as a blueprint for investment management and provides the basis for your relationship with your financial adviser. The statement should include performance benchmarks, a schedule for portfolio review, and other policies relevant to managing the relationship. An up-front discussion with your adviser about the IPS will prevent later misunderstandings. Consider asking your adviser:

1. How often will we meet to go over my portfolio and financial circumstances?
2. What written reports and related materials will be made available?
3. How often will I receive these reports?

As with providers of any other personal service, financial advisers balance their clients’ requests for service with account management time constraints. Keep in mind that an adviser may use preformatted performance reports. If you would like additional information, let your adviser know, but be aware that flexibility will vary with each firm. Understanding your needs will help your adviser determine if he or she can meet your expectations.

INVESTMENT OUTCOMES

Your targeted investment results; the key measurements are often return and risk.

CONSTRAINTS

Investment limitations come in two varieties. Internal constraints include liquidity needs, time horizon, and unique circumstances. Examples of external constraints are tax, legal, and regulatory restrictions.

Educating the Client—You

A financial adviser should be willing to keep you up to date on trends and risks in the financial markets and how they may affect your investment portfolio. You should also expect your adviser to clearly explain his or her reports and other materials and how they relate to the management of your assets.

Your adviser should be aware of your tax situation and discuss the consequences of your investment strategy. He or she should compare the tax efficiency of different types of investments and the tax consequences of holding a given type of investment in taxable and tax-deferred accounts. You should understand the rationale behind the selection of investments with different tax characteristics and how tax-sensitive investment planning should lead to higher after-tax returns.

The Partnership

A financial adviser should be a sounding board for ideas and should provide solid counsel to help you meet your investment objectives. Although you are ultimately in charge, you should remember the roles that you and your adviser play to ensure a successful partnership.

For more information, please consult www.cfainstitute.org/investor

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