Financial advice adds value

Research studies have found that working with a financial advisor can add as much as 4% annually to the long-term return of a portfolio. Advisors offer expertise to guide strategic decisions as well as objectivity that can help even the most sophisticated investors who otherwise may want to “go it alone.”

A professional financial advisor can help you develop a roadmap for a lifetime of financial goals.

Even experienced investors can benefit from the advanced skills offered by a financial advisor, including portfolio construction, comprehensive tax strategies, and behavioral guidance to keep you on track through challenging market conditions. Advisors help investors pursue asset growth while providing ongoing assessment of goals and objectives.

A number of recent studies offer quantifiable proof of an advisor's value. Among other benefits, studies suggest an advisor can increase a portfolio's annual return in amounts that vary from 1.55% to 4.00%.

Three ways advisors can make the biggest impact

Research on the value of advice has examined a range of variables. Of the factors analyzed, there is general agreement that there are three key areas in which an advisor can make a significant positive impact.

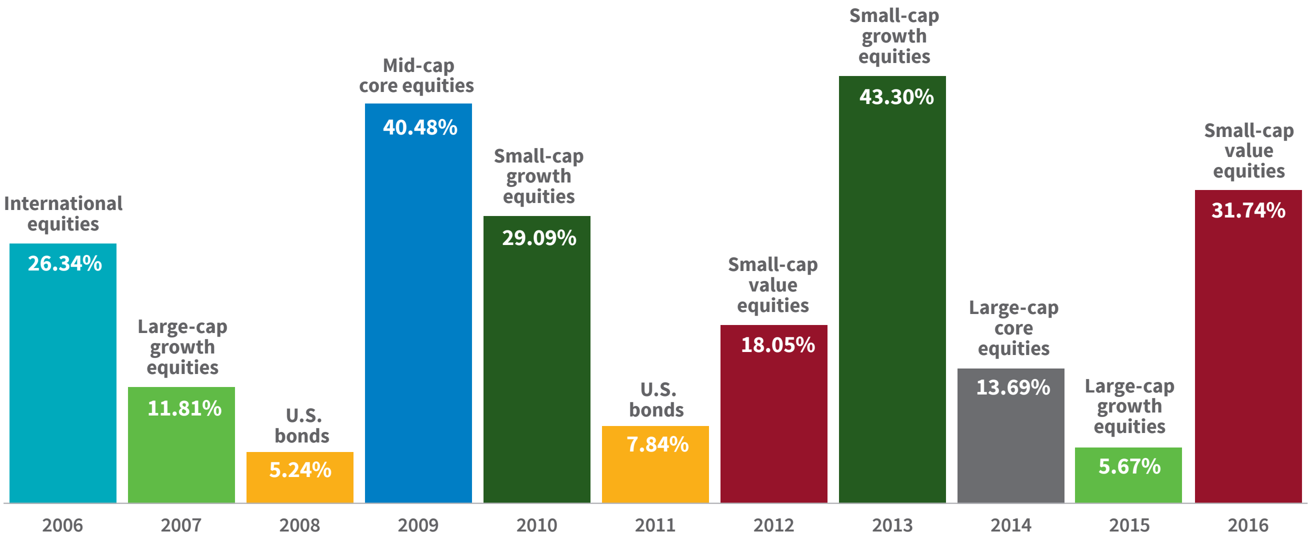
1. Portfolio construction: Asset allocation and rebalancing

Which types of investments should you include in your financial plan, and how should they be weighted and shifted over time? This is a complex undertaking, in large part because the solution may be different for every individual and household. Many do-it-yourself investors turn to online tools and calculators to identify how much and how often to save. Investments designed with automatic diversification features can help, but many people can still benefit from advice on how to properly use such products.

For the advisor, the allocation task entails leveraging knowledge of the markets, looking across a range of investable assets, and selecting those that best fit with an individual's risk tolerance, time horizon, personal goals, and financial situation. An advisor's expertise can make a considerable difference in keeping an investment portfolio on a disciplined course by maintaining appropriate diversification, acting on opportunities, and monitoring financial markets to adjust portfolios in response to changing conditions or variables such as correlations and valuations.

Alternating market leadership is a challenge for investors: Leaders in one year could be losers the next year

An advisor can add value by explaining the importance of diversifying investments across different types of assets, rather than trying to pick winners.



The winning asset classes, and their annual returns, can change considerably from year to year.

Large-cap growth equities are represented by the Russell 1000 Growth Index, which is an unmanaged index of capitalization-weighted stocks chosen for their growth orientation. **Small-cap growth equities** are represented by the Russell 2000 Growth Index, which is an unmanaged index of those companies in the Russell 2000 Index chosen for their growth orientation. **Small-cap value equities** are represented by the Russell 2000 Value Index, which is an unmanaged index of those companies in the Russell 2000 Index chosen for their value orientation. **Large-cap core equities** are represented by the S&P 500 Index, which is an unmanaged index of common stock performance. **Mid-cap core equities** are represented by the Russell Midcap Index, an unmanaged index that measures the performance of the 800 smallest companies in the Russell 1000 Index. **International equities** are represented by the MSCI EAFE Index (ND), which is an unmanaged index of international stocks from Europe, Australasia, and the Far East. **U.S. bonds** are represented by the Bloomberg Barclays U.S. Aggregate Bond Index, which is an unmanaged index used as a general measure of fixed-income securities.

Data is historical. Past performance is not a guarantee of future results. It is not possible to invest directly in an index.

Analysis by CIRANO found that after 15 or more years with an advisor, a household accumulates 2.73 times more assets than a non-advised household.

A Fellowes and Willemin study found that approximately $70 billion is withdrawn by Americans annually from retirement accounts for non-retirement purposes.

2. Tax efficiency: Asset location and tax efficient withdrawals

Just as important as building your savings, knowing when to withdraw assets, and from where, is critical. The effects of inflation and taxes as well as longevity can complicate the decisions. With increasing life expectancies, our savings need to last longer. An advisor can add value by developing advanced investment strategies to address these challenges.

Asset location refers to the strategy of owning investments within certain accounts to maximize tax efficiency. For example, some taxpayers may consider holding a larger percentage of stock holdings outside of traditional retirement accounts to benefit from lower long-term capital gains and dividend tax rates. Withdrawals from retirement plans are generally taxed as ordinary income. At current tax brackets, a taxpayer in the marginal 28% income tax bracket for ordinary income would only owe 15% tax on long-term capital gains and qualified dividends.

Asset location: Allocating assets by tax position

TAXABLE
Equity investments such as dividend-paying stocks or mutual funds

TAX DEFERRED (e.g., traditional retirement)
Fixed-income investments and other income-producing assets

TAX FREE (e.g., Roth accounts)
Growth stocks and mutual funds

Tax efficiency: Strategic withdrawals

After saving, constructing a portfolio, and rebalancing assets throughout your working years, you are faced with another great challenge — using those savings to generate income in retirement or for another financial goal. Planning for retirement income involves some of the most challenging financial decisions investors will face.

When should I file for Social Security benefits? How much can I safely withdraw from accounts in retirement? What account should I draw income from first? An advisor may help provide perspective on these issues, including guidance on executing a tax-efficient withdrawal strategy in retirement. Retirees in lower tax brackets may want to consider drawing funds from traditional retirement accounts such as 401(k)s or IRAs. As income needs increase, it may make more sense to draw from other accounts, such as a taxable savings or brokerage account. For retirees facing the highest marginal tax brackets in retirement, tapping into Roth accounts may be a good idea to avoid reporting additional income at highest tax rates.

MARGINAL INCOME TAX BRACKETS

Lowest (10%, 15%)	Medium (25%, 28%)	Highest (33%, 35%, 39.6%)
Draw from traditional retirement accounts	Draw from taxable accounts or rely on dividends	Draw from Roth accounts if available

3. Behavioral discipline: Long-term focus, commitment to saving

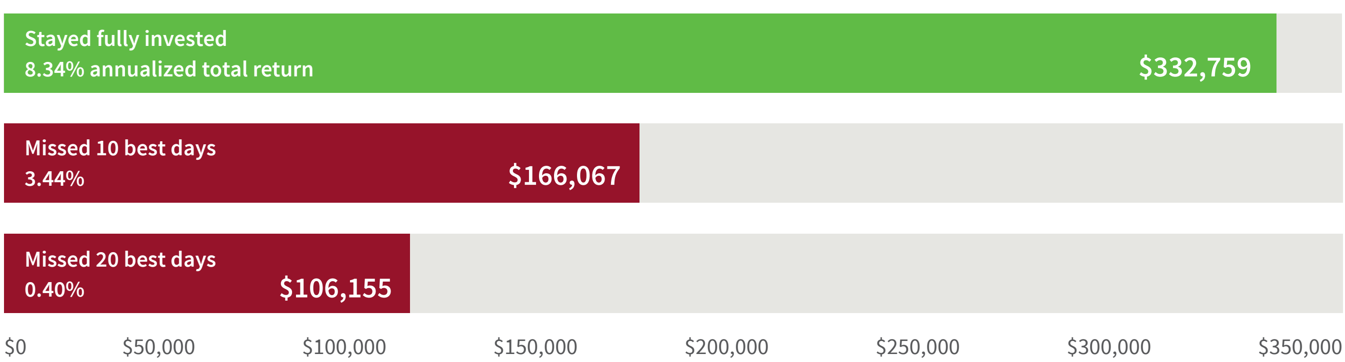
Considering the many financial challenges we face in life — paying off debt, saving for emergencies and our children's education, funding our retirement, and managing our income in retirement — it is understandable why anyone could feel overwhelmed. With decisions that involve such personal issues as income, spending, wealth, and life goals, emotions and biases have the potential to steer anyone off course. In addition to helping to build an investment portfolio, an advisor provides the professional perspective to help investors stay focused on the long term and avoid making decisions based on short-term market fluctuations or alarming headlines.

It is estimated that 70% of Americans lack a long-term financial plan. Working with an advisor not only helps prevent emotionally driven decision-making, it also provides investors with a guide to the investment process. Investors must be engaged in this process and committed to their long-term financial health, particularly because it is easy to be steered off track. According to Sarah Newcomb, a Morningstar behavioral economist, financial health entails both economic and emotional stability. She observes that people are more empowered when they have a feeling of control over their financial situation, and a partnership with an advisor can help facilitate this. In addition, new studies reported by Hermansson and Song (2016) identified value in advice that prompted diversification, improved savings discipline, and encouraged more disciplined behavior in the face of market volatility.

Time, not timing, is the best way to capitalize on the stock market's gains

An advisor can add value by helping you stay invested rather than making the common mistake of trying to time the market. By staying fully invested over the past 15 years, you would have earned over $160,000 more than someone who missed the market's 10 best days.

$100,000 invested in the S&P 500 (6/30/02–6/30/17)



Data is historical. Past performance is not a guarantee of future results. The best time to invest assumes shares are bought when market prices are low.

Research studies quantify the value of advice

Alpha, Beta, and Now…Gamma

Morningstar Investment Management, 2013

Morningstar devised the term "advisor gamma" and defines it as the additional value that can be achieved from making more intelligent financial planning decisions. The study identifies five variables that contribute to advisor gamma, with significant overlap to the Vanguard modules:

The value of intelligent planning decisions

Gamma factor	Gamma equivalent alpha (value added from advice)
Asset location and withdrawal sourcing The importance of utilizing tax-efficient accounts and withdrawing from those accounts strategically.	**0.23%**
Total wealth asset allocation Going beyond risk tolerance to also consider risk "capacity," which is based on an investors' total wealth.	**0.45%**
Annuity allocation A potentially powerful investment solution to address retirees' growing fear of running out of money.	**0.10%**
Dynamic withdrawal strategy Taking withdrawals based on needs as well as portfolio value to avoid overdrawing from an account.	**0.70%**
Liability-relative optimization Hedging risks such as inflation and currency to create a more sustainable and stable retirement income.	**0.12%**
Total potential value added to annual return	**1.59%***

* Data rounds to 1.59%.

Source: Morningstar.

The Gamma Factor and the Value of Financial Advice

Center for Interuniversity Research and Analysis of Organizations (CIRANO) Scientific Series, 2016

CIRANO found that financial advisors induce greater discipline and savings, based on surveys of households that stopped working with an advisor versus those that continued working with an advisor over time. The study found a decline in assets for households that ended the advisor relationship, and asset gains for those households that continued to work with advisors.

CIRANO also found a common assumption among investors — that financial advice is only necessary for individuals with significant assets. Survey findings also show that a willingness to accept advice is necessary and that financial literacy is a complement to — not a substitute for — investment advice.

CIRANO concludes that advisors, when engaged for periods of four years or more, contribute positively and significantly to asset level of their clients. The study found that after 15 or more years with an advisor, a household accumulates 2.73 times more assets than a non-advised household.

Putting a value on your value: Quantifying Vanguard Advisor's Alpha®

Vanguard research, 2016

Vanguard found that paying a fee for financial advice, and looking to a professional with tools and tactics at his or her disposal, can "add meaningful value compared with the average investor experience." The study concluded that **advisors can add about 3% in net returns,** identifying behavioral coaching, spending strategy, and asset location as top areas of contribution. Vanguard outlined seven value-add modules:

The value of best practices in wealth management

Vanguard Advisor's Alpha strategy	Typical value added for client
Suitable asset allocation using broadly diversified funds/ETFs Foundational allocations based on individual time horizon, risk tolerance, and financial goals, and maintaining allocations in the face of headline risk.	—*
Cost-effective implementation (expense ratios) Recognizing the importance of net returns and low-cost investment options.	**0.40%**
Rebalancing Annual adjustment of portfolios to maintain adherence to investor objectives, to minimize risk rather than maximize return, and to stay disciplined, especially when there is dispersion between asset classes.	**0.35%**
Behavioral coaching Acting as an "emotional circuit breaker" for clients prone to market timing. One Vanguard study found that performance of self-guided IRA investments trailed that of target-date funds in tumultuous periods due to exchanging rather than staying the course.	**1.50%**
Asset location Strategic decisions to maximize tax efficiency, including estate planning.	**0–0.75%**
Spending strategy (withdrawal order) This is especially important for retirees who need effective withdrawal strategies for multiple retirement accounts and required minimum distributions.	**0–1.10%**
Total-return versus income investing A total-return approach encompasses income and capital appreciation strategies in pursuit of lower risk and better tax efficiency for longer life spans.	—*
Total potential value added to net returns	**Approximately 3%**

* Value is deemed significant but too unique to each investor to quantify.

We believe implementing the Vanguard Advisor's Alpha framework can add about 3% in net returns for your clients and also allow you to differentiate your skills and practice. The actual amount of value added may vary significantly, depending on clients' circumstances.

Source: Vanguard.

Since our founding in 1937, Putnam Investments has recognized the importance of professional financial advice. For more than seven decades, we have offered a range of funds, strategies, and services — always in partnership with financial advisors who are committed to helping investors pursue their goals.

More on the value of financial advice

The studies consulted for this piece include the following papers, and they can provide additional information about the value of financial advice.

David Blanchett, CFA, CFP®, and Paul Kaplan, Ph.D., CFA: "Alpha, Beta, and Now…Gamma"; Morningstar Investment Management, 2013.

Francis M. Kinniry Jr., CFA, Colleen M. Jaconetti, CPA, CFP®, Michael A. DiJoseph, CFA, Yan Zilbering, and Donald G. Bennhoff, CFA: "Putting a value on your value: Quantifying Vanguard Advisor's Alpha®"; Vanguard research, 2016.

Claude Montmarquette, Nathalie Viennot-Briot: "The Gamma Factor and the Value of Financial Advice"; Cirano Scientific Series, 2016.

Douglas Lennick, CFP: "DALBAR's 22nd Annual Quantitative Analysis of Investor Behavior"; DALBAR, 2015.

Henri-Paul Rousseau: "Is there any value in financial advice?"; Power Corporation of Canada, Remarks to the Canadian Club, 2015.

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