2019 Value of an Advisor Study

How can tax-smart advisors provide maximum value?
Executive summary

At Russell Investments, we are advisor-centric. Your business goals are our business goals. This annual report looks holistically at the real value advisors deliver for their clients, in their portfolios, in vital services advisors provide, and this year, especially in their after-tax returns. We developed a formula to calculate the full value equation of an advisor’s services.

With growing regulatory attention on advisory fees and natural consumer skepticism about delivered value, today’s advisors may be challenged to articulate the material value they deliver. By looking at the full value equation of an advisor’s services—annual rebalancing, behavior mistakes many investors make, the cost of investment-only management, planning and ancillary services, and tax-smart investing—it is clear that the value an advisor can deliver to clients materially exceeds the 1% fee they typically charge for their services.

In 2019, we believe the value of an advisor in the U.S. is calculated at 4.63%.

Introduction

Downward fee pressure. It seems constant, coming from regulators, robo-advisors, passive solutions, and consumer demand. Fees are top-of-mind for many investors. With a record-length bull market performance, based on the S&P 500, there is natural skepticism about paying for advice—it doesn’t seem hard to throw together a winning portfolio. This view completely overlooks the fact that standard investment selection is just one part of an advisor’s value. But often advisors struggle to clearly articulate that the value their clients can derive materially exceeds the 1% fee they typically charge. Let’s make that easier.

The ABCs of advisor value

Coordinating all the needs of wealth management is complex, including the accumulation, distribution, and transfer of wealth. This complexity becomes even more apparent as markets move into a time of potentially lower returns and higher volatility.

The value of an advisor is meant to quantify the contribution the technical and emotional guidance a trusted human advisor can offer.

### A
Annual rebalancing of investment portfolios

### B
Behavioral mistakes individual investors typically make

### C
Cost of basic investment-only management

### P
Planning costs & ancillary services

### T
Tax-smart planning & investing

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Your fee is greater than the annual advisory fee you charge clients
A is for Annual rebalancing = 0.10%

When markets are rising, it can be easy to underestimate the importance of disciplined rebalancing.

Avoiding unnecessary risk exposure. As this chart demonstrates, a hypothetical balanced index portfolio that has not been rebalanced would look more like a growth portfolio and expose the investor to risk they didn’t agree to.

The drift was most pronounced among Total U.S. Equity and Fixed Income allocations.

The potential result of an un-rebalanced portfolio

Additional returns. Regular rebalancing has the potential to add 0.10% in additional returns and 1.7% in risk mitigation.

### Hypothetical rebalancing comparison of $500,000
January 1988–December 2018

<table>
<thead>
<tr>
<th>BUY AND HOLD</th>
<th>ANNUAL REBALANCING</th>
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<tbody>
<tr>
<td><strong>0.10%</strong></td>
<td>Annualized return %</td>
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<td>Standard deviation %</td>
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<td></td>
<td>Ending value $</td>
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</table>

**Reduction in portfolio volatility**  
-1.7%

1For illustrative purposes only. Not meant to represent any actual investment.

Standard deviation is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution. The greater the degree of dispersion, the greater the risk. See disclosure details on methodology and criteria.

Source Portfolio: Diversified portfolio consists of 30% U.S. large cap, 5% U.S. small cap, 15% non-U.S. developed, 5% emerging markets, 5% REITs, and 40% fixed income. Returns are based on the following indices: U.S. large cap = Russell 1000® Index; U.S. small cap = Russell 2000® Index; non-U.S. developed = MSCI EAFE Index (through June 1996), Russell Developed ex-U.S. Large Cap Index (July 1996 to present); emerging markets = MSCI Emerging Markets Gross Index (through June 1996), Russell Emerging Markets Index (July 1996 to present); REITS = FTSE NAREIT All Equity REIT Index (through February 2005), FTSE EPRA/NAREIT Developed Index (March 2005–present); and fixed income = Bloomberg Barclays U.S. Aggregate Bond Index. Start date corresponds to index start dates (January 1988 is the inception of the MSCI Emerging Markets Index).

While 0.10% may not seem like much, compounded over a multi-year period, it can quickly add up. In the hypothetical example above, that’s a $100,000 difference.
is for Behavioral mistakes = 1.90%

Behavior coaching is one of the most vital parts of the advisor job description. It’s inherent in the idea of advising. And when it comes to delivering value, avoiding behavioral mistakes is a significant contributor to total value. Left to their own devices, many investors buy high and sell low. From December 2007 to December 2018, investors withdrew more money from U.S. stock mutual funds than they put in. All the while, $100 constantly invested in the Russell 3000® Index more than doubled in value. And those that chose to stay in cash during that period missed a cumulative return of more than 200%, based on the Russell 3000® Index.

Investors don’t always do what they should. Recent proof of a “buy high and sell low” mentality

U.S. open ended mutual fund and passive ETF flows vs market flows

Data shown is historical and not an indicator of future results.
Sources: Monthly mutual fund, passive ETF flows and Russell 3000® Index, Morningstar, Direct
Data as of February 28th, 2019. Index performance is not indicative of the performance of any specific investment. Indexes are not managed and may not be invested in directly.
No one likes to consider themselves to be an average investor. But statistically, the average stock-fund investor’s inclination to chase past performance cost them 1.90% annually in the 34-year period from 1984–2018. By working with an advisor, investors can become significantly greater than average. We believe an advisor’s ability to help clients stick to their long-term financial plan and skirt irrational, emotional decisions adds this value.

The high cost of investor behavior
1984 - 2018

8.6%

Annualized cost to retail ‘chasers’

10.5%

“Average” Investor

Russell 3000® Index

Source: “Average” Investor – Russell Investment Group, Thomson Reuters DataStream. Return was calculated by deriving the internal rate of return (IRR) based on ICI monthly fund flow data which was compared to the rate of return if invested in the Russell 3000® Index and held without alteration from January 1, 1984 to December 31, 2018. This seeks to illustrate how regularly increasing or decreasing equity exposure based on the current market trends can sacrifice even market like returns. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.
Manage the conversation
Using behavioral finance to help investors manage their human biases.

Loss aversion
Humans tend to prefer avoiding losses than acquiring equivalent gains

Overconfidence
Humans tend to over-estimate or exaggerate our ability to successfully perform tasks

Herding
Humans tend to mimic the actions of the larger group

Familiarity
Humans tend to prefer what is familiar or well-known

Mental accounting
Humans tend to attach different values to money based on its source or location

Can lead to...
Sell winners too early, hold onto losers too long
Trade too often
Buy high, sell low
Overweight home country
Naïve diversification

Can be managed...
Illustrate the connection between their investments and long-term goals
Listen and provide perspective
Focus on long-term goals and emphasize a disciplined process
Diversify and cast a wider net
Money is fungible. Focus on total wealth allocation
What is a bare-minimum investment management worth? To be brutally fair, what would investment management cost if a robo-advisor did it?

Robo-advisors that deliver investment-only management and no financial plan, ongoing service, or guidance have set prices at approximately 0.33%\(^1\)—for annual statements, online access, and a phone number to call in case of questions.

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\(^1\)Based on the average fee charged for investment-only management by 10 robo advice offerings for a client portfolio of $135,205 as accessed on the companies’ websites on 3/11/2019.
Advisors advise. As obvious as this sounds, it’s worth stating that financial advisors add value by doing the hard work of shepherding a strategy from origination to outcome. That means building and regularly updating custom financial plans, conducting regular portfolio reviews, and offering ancillary services such as tax & estate planning, college funding, 401(k) review, investment & cashflow analysis, Social Security and retirement income planning, assistance with annual tax return preparation and one-off custom requests from clients.

How much does the financial planning component cost nowadays?

Per a recent financial planning study conducted by Kitces, the average standalone planning fee for a comprehensive plan was around $2,900, which is 0.58% on a $500k account. Are your clients aware of that value? Don’t minimize it or give it away!

Delivering true wealth management begins with a deep discovery conversation. It is then followed by translating what is heard into goals, circumstances and preferences. The framework is wrapped in a cycle of continuous communication.

Elevate your value: Delivering true wealth management is incredibly valuable

Don’t give it away.
What is the value of typical ancillary services an advisor and their staff offer?

We believe advisors and their staff consistently underestimate the value of the ancillary services—insurance needs, custom requests and questions—they may provide their clients. These additional services can quickly consume 20, 50, or 100 hours each year. If the advisor is providing additional/ancillary services, we estimate that the total planning fee goes up by an additional 0.20%.

In other words, the average standalone planning fee for the most comprehensive plan was $3,918, which is 0.78% on a $500,000 account.

### Planning is complex and varied

- College Funding
- 401(k) Review
- Tax & Estate Planning
- Employee Benefits Review
- Stock Options
- Student Loans
- Investment & Cash Flow Analysis
- Savings & Distribution Analysis
- Regular plan updates & reviews
- Property & Casualty
- Long-term Care
- Disability Insurance
- Life Insurance
- One-off requests for advice

### Planning Costs

\[ \approx 0.58\% \quad \text{On a $500k account} \]

### Ancillary services

\[ \approx 0.20\% \quad \text{On a $500k account} \]

Map your commitment and engagement to clients

One of your biggest challenges as an advisor is to help your clients stay focused and on course. Despite your best efforts, clients sometimes struggle to remember your valuable guidance. A solution to this common problem is to provide them with a Client Engagement Road Map. The Client Engagement Road Map positions you as the coordinator of your clients’ multi-faceted financial affairs. Helping your client articulate and then document their goals and objectives is a critical function. Ask your Russell Investments representative for access to this easy-to-use tool and client-approved value communication materials.

<table>
<thead>
<tr>
<th>WHAT YOU CAN EXPECT FROM US</th>
<th>WHAT WE EXPECT FROM OUR CLIENTS</th>
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</thead>
<tbody>
<tr>
<td>• Transparency into our partnership process, values and priorities</td>
<td>• Openness about your current situation, goals, circumstances, preferences, asset location, and other relevant wealth management information</td>
</tr>
<tr>
<td>• Comprehensive financial planning process—creating, monitoring, and updating your custom financial plan</td>
<td>• Proactive, two-way communication as your situation changes</td>
</tr>
<tr>
<td>• Regular, ongoing, and proactive interactions with our team to help guide you through the emotions that markets, and investing, may trigger</td>
<td>• At least two face-to-face updates/meetings per year</td>
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<tr>
<td>• On-going asset allocation, investment selection, customized portfolio design &amp; construction</td>
<td>• Feedback on our client events and educational workshops throughout the year</td>
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<tr>
<td>• Proactive rebalancing of portfolios</td>
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<tr>
<td>• Tax-smart planning and tax-managed investing</td>
<td>• Annual tax review of your state/federal tax-return</td>
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<tr>
<td>• Help you build a team of experts to meet all your wealth management needs (tax team, trust and estate attorney, insurance, banking, business succession, etc.)</td>
<td>• Introductions to individuals in your professional and personal networks for whom you believe we can add value</td>
</tr>
</tbody>
</table>
Frame conversations to the client’s life and goals
Help clients see their whole financial picture

January – March, 2019
Scheduled activities
• Data Gathering
• Financial Goals
• Risk Tolerance
• Long-range Plan

October – December, 2020
Scheduled activities
• Goals & Situation Review
• Roadmap Review
• Investment Review
• Family Meeting
• ED: Legacy Planning

April – June, 2019
Scheduled activities
• Goals Review
• Roadmap Review
• Investment Implementation
• Life Insurance
• Estate Plans Updated
• ED: Diversification

July – September, 2020
Scheduled activities
• Goals & Situation Review
• Roadmap Review
• Investment Review
• Long-term Care Insurance
• ED: International Investing

October – December, 2020
Scheduled activities
• Review Existing Plans
• Roadmap Review
• Investment Review
• Estate Planning
• Client Satisfaction Review

April – June, 2020
Scheduled activities
• Goals & Situation review
• Roadmap Review
• Investment Review
• Disability Insurance
• ED: Fixed Income

July – September, 2019
Scheduled activities
• Goals Review
• Roadmap Review
• Investment Review
• Insurance Implementation
• Estate Plans Completed
• ED: Long-term View of the Market

October – December, 2019
Scheduled activities
• Data Gathering
• Financial Goals
• Risk Tolerance
• Long-range Plan

January – March, 2020
Scheduled activities
• Goals & Situation Review
• Roadmap Review
• Investment Review
• Education Planning
• ED: U.S. Equities

April – June, 2020
Scheduled activities
• Goals & Situation review
• Roadmap Review
• Investment Review
• Disability Insurance
• ED: Fixed Income

July – September, 2020
Scheduled activities
• Goals & Situation Review
• Roadmap Review
• Investment Review
• Long-term Care Insurance
• ED: International Investing

October – December, 2020
Scheduled activities
• Review Existing Plans
• Roadmap Review
• Investment Review
• Estate Planning
• Client Satisfaction Review

Quarterly Client Engagement Roadmap
It’s not what you earn. It’s what you keep. We believe wise advisors don’t just focus on returns. They focus on after-tax returns. Providing a more tax-smart approach can have substantial impact on the size of those after-tax returns. While downward fee pressure can mean downward value trends in other areas, advisors who focus on tax-smart investing can distinguish themselves and demonstrate differentiating value.

**Dialing down tax drag**

Just how much return can be added with a tax-smart approach? The average annual tax drag for the five years ending December 31, 2018 was significant. Investors in non-tax managed U.S. equity products (active, passive, and ETFs) lost on average 2.06% of their return to taxes. Those in tax-managed U.S. equity funds forfeited only 0.54%. That’s a value difference of 1.52%. With taxable investors holding $8.6 trillion of the $15.7 trillion invested in open-end mutual funds, this is a massive concern—and a massive opportunity for added value.³

**Dialing down the tax drag**

Average annual tax drag (return lost to the tax-payer) for 5 years ending December 2018

<table>
<thead>
<tr>
<th>U.S. Equity Funds (non tax-managed)</th>
<th>Tax-managed U.S. Equity Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>-2.06%</td>
<td>-0.54%</td>
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</table>

³ Source: 2018 Investment Company Factbook.
Tax-smart advisors can help add this value by helping build and implement a personalized, comprehensive, and tax-sensitive investment.

**Helping your clients keep more of what they earn**
Hypothetical growth of $500,000 over 10 years at 7.5% per year

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<td>Initial investment: $500,000</td>
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<td>$849,000 2.06% tax drag*</td>
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<td>$980,000 0.54% tax drag**</td>
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<td>The value of T = $131,000</td>
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*Taxed at 40.8% tax rate: Top marginal rate of 37.0% + 3.8% Net Investment Income Tax, **Taxed at 23.8% tax rate: Long-Term Cap Gain rate of 20% + 3.8% Net Investment Income Tax. This example does not reflect the deduction of state income taxes. If it had, returns would have been lower.

This is a hypothetical illustration and not meant to represent an actual investment strategy. Taxes may be due at some point in the future and tax rates may be different when they are. Investing involves risk and you may incur a profit or loss regardless of strategy selected.
Understanding your client’s tax-sensitivity level

Do you...

- KNOW each client’s marginal tax rate?
- PROVIDE intentionally different investment solutions for taxable and non-taxable assets?
- EXPLAIN to clients the benefits of managing taxes?
- HAVE a process for partnering with local CPAs?
- REVIEW your client’s 1099?

Forensic review of the IRS Form 1099
Connecting the dots between what a client makes and actually keeps

Box 1a: Total amount of dividends to include both qualified and non-qualified

Box 1b: Qualified dividends may be eligible for reduced capital gains rates

Look for:
- Difference between 1a and 1b. Too much non-qualified dividends?
- Does the client need dividend income?

Box 2a: Capital gain distributions. Understand amount as % of total investments. Are gains out of line with investment size?

Box 11: Tax-exempt dividend/interest from municipal bond funds. Know client’s tax rate and tax-equivalent yield.

Russell Investments / 2019 Value of an Advisor Study
The bottom line

The value of an advisor is meant to quantify the contribution the technical and emotional guidance a trusted human advisor can offer.

4.63% > 1%

Advisors delivering services and value above and beyond investment-only advice have an estimated contributory value of 4.63%. At the same time, advisors typically charge just 1% for their services.

By demonstrating to clients how their value greatly exceeds the fee charged, advisors can improve client satisfaction. This value is a meaningful differentiator in a time of margin compression, regulatory scrutiny, and demanding investors.

Your clients are your most persuasive advocates. Helping them understand the value you deliver is key.

This formula offers a memorable and repeatable framework for you to have that conversation with confidence:

```
A  Annual rebalancing of investment portfolios  0.10%
B  Behavioral mistakes individual investors typically make  1.90%
C  Cost of basic investment-only management  0.33%
P  Planning costs & ancillary services  0.78%
T  Tax-smart planning & investing  1.52%
```

\[
0.10\% + 1.90\% + 0.33\% + 0.78\% + 1.52\% = 4.63\%
\]

Let’s rise to the call of providing value to investors.

At Russell Investments, we believe in the importance of advisors. We see the advantages you create for your clients. We know the commitment you bring to your relationships. This annual Value of an Advisor study quantifies that dedication and the resulting benefit. It is one small part of our work in powering advisor success.
U.S. small cap = Russell 2000® Index; non-declining markets. do not assure profit or protect against loss in liquidation).

Drag: Pre-tax return less after-tax return (pre-