equilibrium
asset management

The Naked Truth About Charges

The moral high ground can be a cold and lonely place!

We have taken the stance that fees should be totally transparent and eliminate bias completely. Clients should know exactly what they're paying, what they're getting in return, and they should know that our interests are totally aligned with theirs. They should be able to ask for a full refund if they are not entirely satisfied.

We passionately believe in this approach. Being transparent means that clients can make informed decisions as to whether they think our service provides value for money. It means they know how much they're going to pay in advance, and we know how much we will receive.

As our fees are a percentage of the assets we look after, our interests are the same as our clients' interests. If your portfolio grows, we get paid more. If it falls in value, we get paid less. Our business is valued as a percentage of the assets we manage and so in effect, your capital directly effects our capital.

We don't charge for carrying out transactions so you know that every time we change a portfolio it is because we believe it is in your best interests.

Unfortunately, not all charging structures are as transparent. We believe many advisers and investment managers are charging a lot more than the headline figures would suggest.

In this month's newsletter we'd like to illustrate some of the other charging structures out there, and show how they may be more expensive than you think.

> "Being transparent means that clients can make informed decisions as to whether they think our service provides value for money"

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Commission

This is a traditional remuneration structure for financial advisers and will be banned from the end of 2012.

Commission creates bias and that is why the FSA are banning it, but it's not just IFAs that take commission, stockbrokers and Private Banks are at it too. However, even some fee structures can create bias.

Transaction Fees

Even where advisers or investment managers charge a flat annual charge, there are often transaction fees as well.

A common structure, particularly amongst discretionary investment managers, is to charge for every transaction on top on the management fee. A charge of £25 per fund switch is very common.

If a discretionary manager is using individual stocks, you would hope they would have at least 50 stocks to provide diversification. If they are using funds, they should use at least 20 funds. You would also hope they would rebalance your asset allocation at least once per year, even if they make no other changes.

Don't forget that each transaction is actually two; a sell and a buy. Therefore, rebalancing 20 funds once a year is 40 transactions. At £25 each this is £1,000. This is an extra 1% a year on a £100,000 portfolio.

It also creates a huge bias within the firm. We have calculated that with our 300 clients, a £25 fee could have earned us roughly £90,000 for each switch. For a stockbroker with 3,000 clients, that's possibly £900,000! This would be a massive inducement to make unnecessary changes.

Hidden Extras

There has been plenty of coverage in the press recently about discretionary managers keeping trail commissions from the funds they recommend. For more information, click here to read an article from Citywire (if reading electronically. You may need to register).

Most investment funds have two types of shares:

- Cheaper "institutional" shares, which are only available to institutions investing more than a certain amount, and which pay no trail commission.
- "Retail" units, which are more expensive and typically pay 0.5% pa commission.

Some of the large discretionary managers have been recommending clients invest in "retail" investment funds, even though they have the scale to access institutional shares. Under the terms of their client agreement (in the small print), they retain all trail commission.

So if a discretionary manager says they charge 0.5% per annum plus £25 per trade and they use funds, it is possible they are obtaining a further 0.5% in commissions, plus transaction charges that could add up to a further 1%. These charges are for management only and don't include financial planning.

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Total Expense

If you are comparing advisers or investment managers the first thing to focus on is the total expense. The example below shows the typical total expense for an Equilibrium client with £100,000 to invest, compared to an investment manager with a charging structure similar to that above.

Charge	Example Investment Manager	Equilibrium
Disclosed fee	0.5%	1.5%
Total Switch costs (£25 a trade)	1%	0%
Commissions	0.5%	0%
Fund Charges	1% (retail)	0.6%
Wrap cost*	(n/a)	0.35%
Total cost	3%	2.45%
of which advice charges	2%	1.5%

* Additional charges would apply if pension wrapper required etc.

The second thing to focus on is what you get for your money. For example, our charges include financial planning, tax planning, investment management, and regular meetings.

Transparency is an excellent ideal, but it causes us some issues when our competitors are not playing by the same rules. If you are considering comparing our services against another adviser, we would ask that you give us the opportunity to carry out some competitor analysis. We will help you calculate the true cost and limitations of service, allowing you to make a fair comparison.

Martin Currie North American

We have taken the decision to drop the Martin Currie North American fund within our Global Established portfolio. This fund has underperformed in recent times, although it has done well over the past 6 months.

The US is the largest and most "efficient" stockmarket in the world, and our research shows that it is very difficult for an active US fund manager to consistently outperform a passive "tracker" fund, without taking extra risk. We have therefore decided to use only the Vanguard US Equity Index tracker to gain US exposure within our mainstream Global Established portfolio. We carried out the change for discretionary clients on 11 August 2010.

We will continue to use active US funds within our Global Dynamic portfolio where we are happy for funds to take additional risk and invest in smaller or medium sized companies. The funds we have selected have demonstrated consistent outperformance over a number of periods.

FSA Survey

A number of our clients have been contacted by the Financial Services Authority who are carrying out a survey with the aim of finding out more about the customer's experience when purchasing investment products. If you have been requested to take part in this survey and haven't already let us know, we would be interested to hear about it for our own information purposes and should be grateful to receive any comments you might have.

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Market Views | 10 August 2010

General Economic Overview

GDP growth has surpassed all expectations over the past quarter. Although growth is expected to be muted, the chances of a double dip recession have now faded.

Core inflation is expected to fall but the headline numbers will remain high when the VAT increase takes effect in January. Inflation could become more of a concern in the long term, but it is not currently an issue. We believe interest rates will remain low.

Asset class key

+ positive	+5 strongly positive
- negative	-5 strongly negative
= neutral (normal behaviour)	

	Outlook
Equity Markets Equities still look good value but less so than last month after a strong recovery since then. The FTSE Allshare Index is now trading on a price/earnings ratio of 12.2x compared to the long term average of 14x, with earnings still predicted to rise. We remain positive on equities and expect some decent returns over the next 18 months, although we expect short term volatility to continue whilst investor confidence remains fragile.	+3
Fixed Interest Gilt yields remain very low, making corporate bonds look attractive in relative terms. Although we believe gilt yields will have to rise at some point (meaning capital values will fall), we do not think this will be a sharp move. In a low growth, low interest rate environment, corporate bonds continue to offer good relative value.	+1
Commercial Property The rental yields on the commercial property index remains very attractive being around 6.5% pa. However, returns are now cooling off after a strong past 12 months. Property funds have seen huge inflows meaning they are sitting on high cash levels. This is a drag on returns as is the cost of buying the properties as they invest the cash. However, it should reduce liquidity risk. The lack of new building in the past two years could lead to a lack of supply further down the line, potentially pushing up prices longer term.	=
Residential Property Residential property prices have begun to fall again as supply is now outstripping demand. We believe they this could continue for some time due to the current lending conditions.	-1
Cash With interest rates remaining at record lows, returns on cash are as low as they have ever been. Bank of England base rates are likely to remain at 0.5% into 2011 and perhaps well beyond, even though one member of the Monetary Policy Committee is now pushing for a small rise.	-5

These represent Equilibrium's collective views. There are no guarantees, although we hope to be right more often than wrong. We usually recommend holding at least some funds in all asset classes at all times and adjust weightings to reflect the above views. These are not personal recommendations so please do not take action without speaking to your adviser.