

# Measuring Advisor Returns

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You can measure advisor returns by establishing a benchmark. Returns over benchmark measure advisor performance. In a preferred method an expected long term rate of investment return before advisor fees may be established for each risk tolerance. The Dow Jones US Total Market Index is meant to measure performance of the US stock market as a whole. In the preferred method a benchmark such as Dow Jones US Total Market Index Fund (symbol IYY) is established for each client based on risk tolerance and expressed as a multiplier of IYY. It is commonly held that the total US stock market has given off a return of 10.5% including inflation over a very long period of time. In the preferred method, the risk tolerance adjustments are conservative (IYY x .57), moderate (IYY x .71), aggressive (IYY x 1), or moderate aggressive (IYY x .86). Different multipliers are used because for example a person who is conservative cannot expect to make as great a rate of investment return as a person who is aggressive.

By applying the multiplier for each given risk tolerance, an expected long term rate of investment return may be established for that risk tolerance. For example an aggressive risk tolerance person would use a multiplier of 100% times 10.5%, which may yield a long term benchmark of 10.5%, a moderate aggressive risk tolerance person would use a multiplier of 86% times 10.5%, which may yield a long term benchmark of 9%, a moderate risk tolerance person would use a multiplier of 71% times 10.5%, which may yield a long term benchmark of 7.5%, and a conservative risk tolerance person would use a multiplier of 57% times 10.5%, which may yield a long term benchmark of 6.0%.

It is common practice for advisors to establish for each client a distribution ratio. By multiplying a distribution ratio by a pile of money, an amount of money, called THE NUMBER, that may be spent per year in retirement may be found. According to Investment News on October 11, 2009, 90% of advisors use distribution ratios that range from 3% to 6%. Actual investment returns limit distribution ratios.

In the preferred method excess returns are defined as gains over the benchmark. Beating the benchmark is a significant way that the client can measure an advisor or wealth manager or broker. An advisor recommended low withdrawal rate may mask substandard actual rate of investment returns. The risk to the client of substandard actual rate of investment returns is a reduced standard of living in retirement.

In the preferred method, the client may make revisions to expected long term rate of investment return. For example, rate of investment return as a client stated assumption may be compared to actual rate of investment return. In the preferred method, both THE NUMBER is expressed as a compound return and the actual rate of investment return is expressed as a compound return so a direct comparison may be made.

Thru revisions to any client stated assumptions the client may get ever closer to an accurate estimation of THE NUMBER. The client may adjust expected long term rate of investment return based on advisor excess returns or a lack thereof. Revisions to client stated assumptions may increase in clarity over time. An accurate estimation of THE NUMBER is essential prior to retirement and during the period of retirement. Thru revisions during the period of retirement accuracy of THE NUMBER improves with client experience.

A fiduciary advisor by law puts the needs of the client ahead of the needs of the advisor. Fiduciary advice along with client revisions to client stated assumptions may put the needs of the client ahead of the needs of the advisor.

The significance of excess returns is that over a long period of time cumulative excess returns may help to protect the client from returns that fall below benchmark in any given year. The more cumulative excess returns, the less likely that single incidences of returns below benchmark may drag down actual rate of investment return to the long term benchmark. Stated another way if cumulative excess returns exist then the long term benchmark may be more likely to be the expected long term rate of investment return or better. Cumulative excess returns measure advisor performance. Jacki Liautaud (312) 666-7587