candid financial advice
bringing down the cost of advice

Paying for Performance

A Candid Financial Advice guide

Straightforward guidance
helping you make good decisions

Candid Financial Advice
About Us

Premium financial advice at a fair price

Candid Financial Advice was born out of old colleagues, Justin Modray and Ian Millward, wanting to launch an advice firm that does the right thing for its clients.

Since launching in 2013 the business has flourished, thanks to attracting a steady flow of clients and looking after them well.

We provide independent financial advice to individuals across the UK from our office in Bath. Our expertise is looking after people who are retired, or organising their finances in readiness for retirement.

Our role is to help you make great decisions and then take away as much of the pain as possible, giving you peace of mind that your financial affairs are being handled professionally and cost effectively.

What sets us apart is putting your interests first, providing premium advice and service at an affordable price. We work with clients remotely via phone and/or video chat, forging really strong working relationships. The overwhelming feedback is a significant advice and service upgrade, along with greater trust and confidence. The bonus is cost savings often running into thousands of pounds a year.

Content
Paying for Performance

Paying for performance
An introduction

“Charges don’t matter. It’s the returns after charges that matter”

“We only pick the top performing funds”

“This is how much more money you could have made had you invested with us 5 years ago”

How many times have you heard statements similar to those above?

The basic argument is that you shouldn’t pay too much attention to investment costs and instead focus only on the returns that you receive after charges.

In theory it’s a sound argument. After all, it doesn’t necessarily matter how much someone else is earning as long as you are doing well.

But it does rely on the hope that paying experts shifts the odds sufficiently in your favour to outweigh their fees. So, it may sound convincing, but how true is it really?

In this guide we’ll review arguments around performance, charges and even our own decision-making ability.

Highly paid fund managers invariably talk a good game, but few deliver

Here is a brief overview of the key points we’ll cover.

Active versus passive

The debate around passive and active investing has raged for years.

Highly paid fund managers invariably talk a good game, but few consistently deliver.

And while passive (index-tracking) funds are usually very low cost, they don’t outperform all active managers and can skew your portfolio towards the largest companies and sectors.

So, we’ll start by reminding ourselves of the arguments for and against both types of fund.

Expert fund pickers

Most people now accept that picking winners is a lot harder than it sounds.

But can financial advisers and other investment professionals use skill and judgement to beat the market on your behalf? Or are they just adding in more fees to overcome?

Counting the cost

Investment costs are not always easy to follow or understand, and the differences often seem relatively small in the scheme of things.

We will look at the impact that these, seemingly small differences, have on the value of your investments over time.

Wanting to believe

Finally, we will delve into behavioural factors.

Just how much can we trust our own judgement on what to buy, when to sell or even whether to put our trust in the person sitting in front of us?

Active vs Passive
Which is the better option?

A quick recap

Active funds

Funds run by professional managers who (in theory) invest differently to the Index, picking companies and/or sectors they believe will outperform.

Passive funds

Funds that aim to mirror a specific investment 'Index' (e.g. FTSE 100), by holding the same investments as the Index in the same proportions.

Active fund managers believe they can beat the market through research, analysis and judgement. This means not only picking winners but, just as importantly, avoiding losers.

In the 1960s, an argument emerged that markets are efficient and price in all available information, meaning attempts to outperform are more a game of chance than skill.

This later led to the launch of tracker funds, also known as "passive" funds. Instead of trying to beat the market, they simply own all of it. So, a FTSE 100 tracker fund holds all the 100 companies in the index, with the goal of mirroring returns.

Which does better in practice?

We know that world stock markets are often irrational rather than coldly efficient. And it is certainly true that the best active funds will do better than a passive fund.

However, the challenge lies in finding them, and history shows that passive funds beat the majority of active funds over the long term.

And, even when an active manager has done well in the past, they often struggle to repeat that success.

So, which should you hold?

Arguably a mix of both. Whilst the argument for low-cost index-trackers is strong, they are not without their potential flaws.

Most indices are weighted, meaning they can be dominated by the largest companies and sectors.

And not all markets and sectors lend themselves well to tracking.

This can mean that investing solely in trackers can lead to a more skewed portfolio.

Active managers offer the potential for outperformance but, arguably just as importantly, they offer a different way of doing things. This might mean accessing more specialist sectors or contrarian thinking in traditional markets.

Both active and passive funds have their merits and a blend of the two is often the most sensible option.

Zero sum game

This means that for someone to win, and beat the market, someone else must lose.

Whilst this is easy to understand in games like tennis or chess, it is not always so obvious when it comes to investing.

Nevertheless, it is true. Investors, as a group, must earn exactly what the market returns. No more and no less.

They only fall short of this figure by the aggregate amount they pay in charges. Once you accept this, it becomes a little clearer why controlling costs is so important.

Active funds charge significantly higher management fees and tend to buy and sell their underlying holdings more frequently. This increased 'turnover' means more dealing fees and stamp duty. And their inability to offset this increased cost contributes to so many funds underperforming.

Active managers beating the Index each year

80%	9%	51%	54%	14%
2022	2021	2020	2019	2018

The above figures show the proportion of active managers in the IA Global sector beating the MSCI World TR Index over the 12 months to 9 June of the year shown. Calculated from data supplied by Financial Express.

21%

The proportion of active managers beating the Index over the whole 5 year period (details as above).

Selecting funds
Can using an expert improve your chance of success?

Since identifying which funds will be future winners is tricky, many enlist the services of a professional

Most people have no interest in picking investments and running a portfolio for themselves. And many who do are ill-suited to the task.

Poor investment decisions can have life changing consequences, so it is understandable that many people choose to enlist the services of a professional. And there is no shortage of firms lining up to help you select investments, or manage a portfolio on your behalf, ranging from financial advisers and wealth managers to investment platforms and 'robo'-advisers.

But how good are this group at actually picking winners and beating the market? And is it worth paying a higher fee to increase your chances of success?

How successful are the experts?

There is skill involved in putting together and maintaining a sensible portfolio through challenging times. And research and analysis can help you identify if a fund manager has changed their style or maybe simply got lucky by being in the right sector at the right time.

Who are the experts?

Most investment platforms offer up suggested 'best buys', whilst robo-advisers, funds of funds, multi-managers and discretionary services all typically manage a portfolio of funds.

Financial advisers might also pick funds, although they increasingly outsource the job to some of the above.

But what about the big market calls? Or comparing the small handful of top performing managers to tell you who will perform best in the future?

Unlike the debate between active and passive funds, it is much harder to find clear empirical evidence either way. That is because there are so many different kinds of services, and portfolios are often bespoke meaning finding comparable data is difficult.

But this lack of evidence tells its own story. Some managers will outperform shorter term (to offset the underperformers, as you'd expect in a zero sum game). But what about evidence of sustained, repeatable success?

This is much harder to find. Indeed, there are plenty of examples of the UK's leading advice firms holding funds that have performed poorly. A big financial scandal in recent years was the suspension of the Woodford Equity Income fund in 2019, whilst the fund was still being recommended by some of the UK's leading 'experts'!

"… be extremely sceptical about claims of investment outperformance to justify charges"

The notion that a breed of 'master' managers exist seems fanciful at best. If they possessed those skills, they would quickly become star managers themselves.

The suggestion again is that, as a group, they are average and will only fall short of this by the aggregate amount paid in charges.

Once again, costs can mean the difference between success and failure.

The value of advice

This does not mean financial advisers are not doing something valuable for you.

- A good adviser is akin to a financial life coach; they can help you see through the fog and understand potentially complex issues to make better decisions
- They can help you avoid ill-judged investment decisions whilst building and maintaining a sensible portfolio
- Tax is a form of cost too, and there are practical ways an adviser can help you reduce tax, like regularly using your annual ISA and capital gains tax allowances or working out the best way to access your pension
- One of the most important things an adviser should do is help you manage your emotions and give you the confidence to stay the course during the inevitable tough times and market falls

Charges
Their impact on returns

How charges reduce returns

Instead of imagining near open-ended returns based on picking the winners, it's more realistic to assume the market average as a return. And costs will then reduce this.

So, what is a realistic starting figure to assume? Stock market returns are notoriously erratic and even comparing one 5 or 10-year period to the next usually offers very different results.

However, for the purposes of a reasonable comparison let's assume annual returns before charges of 5% and 7.5%. And then deduct charges ranging from 1% to 2.5% a year.

Bear in mind these figures only show the impact of annual costs. In many cases upfront costs will also apply.

The impact of annual charges - value of £500,000 invested after 10 years

Total annual charges %	Annual Return (before charges)	
	5.0%	7.5%
2.50%	£640,041	£814,445
2.00%	£671,962	£854,068
1.50%	£705,301	£895,424
1.00%	£740,121	£938,565

Lower charges make a big difference, as highlighted by the chart below showing the projected additional return after 10 years for total annual charges of 1%, 1.5% & 2% versus annual charges of 2.5%.

Outperformance
Chasing the rainbow?

Why are we so susceptible to claims of outperformance?

The fund world is littered with former 'stars' who later return to earth with a bump.

Arguments around controlling costs and shaving off small percentages don't seem exciting compared to the allure of enticing past performance.

Our eyes are drawn to the winners and confirmation bias leads us to look for information that suits the belief we want to hold and downplay information which contradicts it.

Have you ever held on to a poor investment until it returns to its starting value?

That is because we hate losing money. Loss aversion leaves us prone to holding on to poor investments, even when we might be prepared to sell a perfectly good one.

An unlevel playing field

Fund groups often heavily promote 'winners', and it takes willpower to resist both this and trying to second guess the next 'big thing'.

Most advice relationships are conducted in person and human nature is to trust. Even when we recognise a relationship is less than perfect phrases like ''out of the frying pan and into the fire' and 'better the devil you know' can prevent you from acting.

And because charges are often opaque and paid from money you never see they somehow don't feel quite as real as handing over cash.

Are you chasing the rainbow?

Investing is sometimes described as simple, not easy. That is because investing can be simple but these powerful forces, and many others, can conspire to lead you off the path.

Conclusion
Costs matter

Cost and trust are inextricably linked

Costs, just like returns, compound over time and seemingly small differences in costs result in potentially life-changing outcomes.

Paying high charges really is as simple as money that should be in your pocket, sitting in someone else's.

It can mean giving away up to a third of your potential returns (potentially more for cautious portfolios with lower growth expectations) and materially alter your standard of living in retirement.

Instead of an invitation to sign on the dotted line, claims of outperformance to justify higher costs should be a signal to run for the door. Cost and trust are inextricably linked.

Which begs the question, what is a fair fee?

A 2020 report by the Financial Conduct Authority stated that annual advice and investment costs average 1.9% (0.8% for advice and 1.1% for investments, it made no mention of platform costs). The same report says upfront advice fees average 2.4%.

For our part, we aim to keep total annual fees as near to 1% a year as possible and upfront fees are usually well under 1%.

What's more, we are one of the few advisers who openly publish their fees:

www.candidfinancialadvice.com/what-you-pay

Calculators

Use calculators on our website to find out how much we'll charge and the potential savings versus your existing adviser.

A final word
From us

We spend a lot of time helping our clients make good decisions, of which sensible investing is key. Our disciplined, diversified, low-cost approach has proven itself through market crashes, wars and pandemics.

If you have found this guide useful, please visit our website, where you'll find a host of useful information. And if you have any questions feel free to give us a call or email.

Best wishes,

Justin

Justin Modray
Founder

Lower Costs

We expect you'll make significant savings versus any comparable service.

Better Advice

Our advice is centered around putting your interests first.

Improved Service

Our clients rate us over 9 out of 10 across a range of areas, including service.

Experts

Our views and comment are regularly sought by the National Press.

Small print

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