News

TAKING CONTROL WITH DIRECT INVESTMENTS

By Janine Mace on 16 August 2010 0 comments 15 views 1 retweet

Disillusionment with the financial services industry and its products; a desire for control in a chaotic world; investors stuck in frozen funds; a fee line that looks a lot larger against lower returns; a shift to asset-based remuneration: it's a potent brew, and it's dramatically changing the face of the Australian investment market.

While some investors are so disenchanted they are ditching their advisers and going it alone with direct share trading and investing, others are choosing to stay with their adviser and bypass pooled investments vehicles like managed funds.

Investing directly gives investors a greater sense of control and a feeling of being closer to their assets – something that is very important in a post-global financial crisis (GFC) world where there is a legacy of distrust. This trend has shown up in the investor surveys undertaken by Investment Trends, according to the research firm's director, Mark Johnston.

"We noted during the GFC a certain number of investors had started to distrust both the financial services industry generally and also managed funds," he says. "We have found the distrust didn't go away after the GFC, and the appetite for direct equities increased strongly."

In fact, the Investment Trends 2010 Online Broking Report found while there were 600,000 users of online trading in 2009, by mid 2010 the number had grown to 650,000.

E*Trade managing director Stuart Sayers agrees some people are embracing the idea of do-it-yourself (DIY) – not just when it comes to investment, but right across the financial services industry.

"We see strong evidence of people wanting to do it for themselves. This is mirrored in the online banking data we see from ANZ, and it is apparent across all financial services businesses," he explains. "Online is now completely mainstream and the barriers to this are eroding over time. Anecdotally, we are seeing people fully offline and then they slowly move bit by bit online."

Broken trust and failure

According to Sayers, the move towards DIY is driven by several trends, one of which is the lingering anger over the failures during the GFC.

"Research indicates 20 per cent of people who are trading again are doing it themselves as they don't trust fund managers, or they are not happy with their full-service stockbroker," he explains.

Johnston believes trust is an issue with certain clients, particularly in older age groups. "There is potentially quite a large segment who agree with that sentiment. This is an ongoing issue for the industry," he says.

Simon Robinson, senior private wealth adviser at Wilson HTM Private Asset Management, agrees many clients still retain strong feelings of disenchantment.

"Many investors are disillusioned in terms of funds and fees after the GFC, and they are focusing on alternative ways of managing their money. This is a theme that has picked up a lot," Robinson says.

However, CMC Markets chief market analyst David Land believes the swing toward direct investment needs to be seen within the context of the turmoil of the GFC.

"There has been a trend toward direct investment, and post-GFC surveys saw an aggressive swing to this.

But while it is still a relevant factor, we also need to see this view as occurring in the aftermath of such a dramatic event. I wouldn't be surprised to see it abating," he says.

The upheaval of the GFC has created a new sense of caution, and this is encouraging many investors to ask more questions.

"Post GFC, people are feeling quite shocked at the drops in so many markets at once," Land says.

"This means people are now taking a more active interest in their investments. People are more knowledgeable, and when they take advice they want a better understanding of how it all fits together.

"The average investor is now better educated about investing and the way they approach their investments, but this does not nullify the use of an adviser," he says.

Drift away from managed funds

Although most people associate direct investment with online share trading and investors going it alone, this is not necessarily the case. To many investors, direct investment simply means bypassing pooled vehicles like managed funds – a trend being supported by many advisers.

"The growth area for advisers has been direct equities and we have seen a big spike in direct equities use. The direct equities story is really significant at the moment," Johnston says, pointing out that the 2010 Planner Direct Equities Report highlights this trend.

"The proportion of inflows into managed funds has been drifting down, but now only 50 per cent of new inflows are going into unlisted funds. A year ago that figure was 62 per cent," he says.

"Over the past five years this had been drifting down, but there has been a substantial change over the first six months of this year. This is partly due to the change in the financial planner remuneration model."

According to Johnston, the industry is going through a very rapid period of transition.

"It will take time to see if these are temporary or permanent structural changes. However, financial planners are saying their direct equities inflows will be increasing over the next three years and ETFs will also be used more," Johnston says.

Even the popularity of DIY is not a one-way street, with investors falling into different groups at different times. Some advisory clients are going direct when it comes to some asset classes, despite remaining loyal to their financial adviser.

"There are people who want to get advice at some times and not at others," Sayers says. "People are happy to make the calls some of the time but not all the time, so financial planners will always have a role."

Land agrees: "Sometimes they may be very active in some parts of their portfolio such as direct property, but not in others where they have less interest."

Robinson believes the growth in self-directed investment is only part of the picture. "There has been an influx of online brokers, but the GFC highlighted the value of full-service broking," he argues. "Research is very important and investors are increasingly aware of its value."

Land believes the advisory role remains important, "particularly as the market starts to temper and level out". He is philosophical about the future of the advice channel. "The market conditions may see peaks and troughs, but people still want to take advice when they are investing large amounts of money, or for the long term," Land says.

This is reinforced by the findings of the IFSA/CoreData Quarterly Investor Sentiment Research Report (July 2010). It found over three in five people with an adviser (62.5 per cent) felt financially secure compared to 46.4 per cent of those without an adviser. "When you are making a decision on the Internet it can be very complex, lonely and tricky when things get difficult," Robinson says.

Motivations for investment

While the damage from the GFC may be fading somewhat, the psychological scars it has inflicted on investors may take longer to heal.

According to Robinson, the crisis has led to a change in investors' underlying behaviour.

"We have seen behaviour modification in terms of the way investors go about trading. In the pre-GFC period, high-net-worth clients were more aggressive in the trades and risks they were prepared to take. Now they are more conservative and less aggressive in their approach to trading and they are seeking more diversification," he says.

The anxiety created by the GFC is a clear motivator for many users of financial services products.

"Absolutely it is about cost, convenience and control. People want to have greater control – both perceived as well as real – about when and how they do things," Sayers says.

Land believes the crisis punctured peoples' complacency about their investments, and they now want more control and a more detailed understanding. "There is increased interest in investment, even within peoples' social networks," he says.

The ready availability of additional information and product offerings via the Internet is making this a more viable option. "More providers are offering access to products that were previously only available to high-net-worth clients," Sayers says.

In an increasingly busy world, the convenience of DIY is also coming into play.

"People want to serve themselves, because it is more convenient. They want to trade now, not wait for someone to call them back and put the trade through for them," Sayers explains.

Cost is also an important consideration for many investors in the post-GFC world.

"Underlying the increasing appeal of direct shares is an increasing focus on costs and fees by investors," Johnston says.

Land agrees: "In good markets cost is less of a factor, but there is more interest in lower markets. It depends on the phase in the investment cycle."

While acknowledging that cost matters, Robinson believes the upfront cost of investing via an advisory channel is balanced out by the advice and security it provides.

"The 2-3 per cent cost in terms of using a broker is cheap compared to the 50 per cent you can lose without that advice and research capability," he says.

"Investors can now see that paying that 3 per cent would have saved them X dollars, and that is leading them to refocus on the value advice can provide."

One factor that seems to be less of a motivation for direct investment is tax.

"There is less concern about tax than on the return from the investment. Those people who were focusing on tax lost the tax gains they had in the GFC," Robinson says.

Product proliferation

To cater to the growing group of self-directed equity investors, providers are adding a host of new features to their online trading platforms. For example E*Trade recently released an ungraded version of its free Tax Tools Standard service for DIY investors. The Tax Tools Plus and premium subscription services offer a wide range of interactive features permitting customers to prepare up to 14 in-depth tax reports.

"You can run 'what if' scenarios on share parcels with different tax treatments to maximise or minimise your tax," Sayers says.

The premium service offers even more tools for the motivated direct investor and increasingly resembles a complete – and much cheaper – administration service.

"You can add in different asset classes such as art, wine or property and use it like a wrap platform. The tax functionality is like a wrap functionality at a low annual fee," Sayers says.

"Two years ago you had to be in a wrap and pay thousands of dollars for this service, or pay an accountant $2,000-$5,000. Now you can do it yourself for $479 per year."

Investors can even buy global shares online.

E*Trade's new online international trading service, Global Shares, offers access to 11 of the world's largest equity markets, including the New York and London stock exchanges. According to Sayers, the service was introduced in response to continuing questions from customers about access to overseas shares and big global brand names like Google.

“We are seeing demand for overseas share trading to get diversification in other sectors such as IT and healthcare,” he says.

“Also there are increasing numbers of people who have lived or worked overseas and who are keen to get access to overseas investments.”

What does it mean for advisers?

The trend towards direct investment will have significant implications for those currently operating advisory businesses, according to the experts.

Although Johnston says his research indicates planners believe they have as many clients as in the past, his data indicates they may have lost more than they think.

“There has been some net decline in the usage of financial planners, stockbrokers and other advice providers,” he says.

“However, our latest research finding is that clients are coming back to advisers. It definitely did decline during the GFC, but there could be a swing back in the propensity to use advisers occurring now.”

Although this is comforting, advisers cannot afford to rest easy. Sayers believes the swing away from advice should encourage advisers to think hard about what they are doing to provide value to their clients. He has a clear view on what this means for advisers of all kinds.

“If you are just placing a trade then you are not adding value. You need to think harder about how you are bringing value to your customers,” Sayers argues.

Land agrees: “Value for money is the key thing people are looking for. People are happy to pay if they feel they are getting good value for money.”

This means ensuring you are meeting client expectations. “People want to feel their financial planner or broker is operating with their best interests at heart,” Land says.

Planners also need to think about communication, and ensuring they are giving clients what they want.

“Most people looked at the GFC and accepted their losses as everyone lost. However, what compounded the loss of money was a feeling of being let down and a lack of communication by their financial planner at the very time when it was most needed,” Sayers says.

Robinson believes while advisers need to have a strong value proposition, there are some investors for whom no argument will be strong enough to enable them to see the value of paying for advice.

“The client needs to understand the value proposition we are offering to see the benefit of advice. But if they cannot understand it then they are not a suitable client for our services,” he says.

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