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ADVISOR'S EDGE

BY

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COVER FEATURE

BACK ON TRACK

Client income shifts open doors for holistic advisors.

They wanted it all, so they went out and got it. Then the bills came due.

Sounds bad, but perhaps it's not. If there's a silver lining in the clouds of this recession, it may well be the fact that so many clients have woken up to their excessive spending habits and have started talking with their advisors about how to change them.

[CLICKABLE]

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If your house is too much for you, can you spend \$30,000 to put in a basement apartment and make \$1,000 a month?

In some cases, clients have lost one of the two incomes within their households, said goodbye to bonuses, or didn't get anticipated raises. Whatever the case, it represents an opportunity for advisors to get closer to clients and cross the bridge between being an equity advisor, to becoming a true planner.

Brent C. van Ryzewyk, a principal at Barron's Financial Group in Mississauga, Ont., says the problem often starts with Know Your Client forms that really don't gather enough information to help advisors understand client needs. Most consumers turn to their advisors to make serious recommendations, but that's hard when KYC forms only ask "What's your time horizon?" and "What's your risk profile?"

"That's too simplistic to plan for a lifetime of contingencies," he says. "You have to go deeper." In response, he's

beefed up his KYC process and uses the results to divide clients into three types: Vulnerables, capables, and those who are in surplus.

"The vulnerable category dreams outside of the box a lot, and the planning they've done falls apart," he says. "They over-contribute to their RRSPs, and then they have to collapse them to cover other needs."

THE TALK

It's hard to tell clients they spend too much, but sometimes it's an advisor's duty to speak up. People will never save if they don't curtail spending and there are simple tools to help clients save. The key for advisors is to find out where clients place their priorities. **[NEXT]**

Harry James, president of Harry James Financial in Markham, Ont., says there's one serious downside to level-

ling with clients: "You run the risk of completely offending people," he says.

James says one of the biggest challenges to proper planning is advisors' inability to shake the notion that they should become friends with clients.

"We have lunch, and build bridges that endear us to clients," he says. And that can become an obstacle when the advisor has to dispense advice that can be hard-hitting like, "You're 50 feet from the Go Train and you're spending \$1,500 a month on car leases. Yeah, it's a cool car but it's not working financially," or "You live in too much house."

"The Talk" starts by drawing the line with clients between what's flexible in their budgets, and what isn't. The rent or the mortgage isn't negotiable; but people can control what they spend at the big box shopping plazas every two weeks (see "Simple Solutions").

"All the horrendous stuff we've been through with this meltdown has woken people up to the idea that overspending will eventually come home to roost," says Sherry Cavallin, a financial consultant with Assante Financial Management and Integrated Planning Group in Vancouver. "People are coming to realize it's not about the stuff. In fact, the stuff has limited marginal utility."

That's exacerbated by the fact advisors these days find they frequently need to explain to clients that their lifestyles have been dictating their incomes—when it should be the other way around. And when an advisor bases the practice on being everyone's best friend, it's too hard to tell clients things they don't want to hear.

Instead of asking clients about investment objectives, van Ryzewyk speaks directly to the issue of what clients want to do with their money. Do they want to spend it all now (and some do) or grow an estate for their heirs? Answers to those questions get to the core is-

sues and help advisors understand what drives a client financially over both the short-and long term.

“This lets you develop a track to measure product suitability,” he says. “I think strongly about client accountability. Planning is second or third on the list.”

Further, James warns clients against solutions that treat symptoms rather than problems—such as consolidating debt, when they have cash flow issues. In some cases, the carrying costs attached to such borrowing end up robbing people of any equity they may have amassed from their other assets.

“I don’t want to keep consolidating your equity,” James says. “If your house is too much for you, can you spend \$30,000 to put in a basement apartment and make \$1,000 a month? If you can get \$12,000 annually, that’s a good rate of return on the investment.” He adds it’s also a more responsible use of debt, because it’s tied to a guaranteed return and the improvements will increase the resale value of the owner’s home.

By looking at cash flow in isolation, and then showing how it integrates with a client’s overall wealth picture, James says advisors and clients are able to implement solutions that actually treat problems, rather than symptoms.

PULLING THE PLUG

Retiring clients have a lot in common with clients who have lost jobs or are dealing with reduced incomes. Both groups have to learn to live on less, and advisors can take the lessons from downsized clients and apply them when people transition to retirement. **[NEXT]**

Contrary to popular belief, over-extension isn’t isolated to six-figure executives, notes Cavallin.

She’s fortunate not to have too many vulnerables in her client base. But she is seeing clients who were planning on

retiring within the year, and having to make serious lifestyle decisions.

Cavallin believes advisors working with clients caught up in downsizing or income declines are experiencing what amounts to a training exercise that will come in handy when clients retire. “If a person is downsized, they have no choice,” she says, “but people can wait to retire if the money’s not there.”

A lot of her clients are saying they want to pull the plug next year, and are wondering what that’s going to feel like. So, she’s having the same types of discussions about what it means to live on more limited funds for different reasons. But no matter the circumstances, the conversations have to start with a hard look at where the client’s money has been going.

The problem, of course, is that the answer to the question “Will I be okay?” depends on a lot of factors. To answer correctly, an advisor needs to look the client in the eye and say, “Tell me how much you’re going to spend every month.” It’s a highly personal question, and to plan properly the advisor needs to get a credible answer.

“It’s not that I care where you spend your money, it’s that I have to know where you spend your money,” says Cavallin. “I can’t just say, ‘If you have \$1.5 million you’ll be fine,’ because

people have very different needs.”

For most soon-to-retirees with healthy nest eggs, she’ll advocate an annuity so that part of their income works more or less like a pension and covers off monthly needs. Beyond that, Cavallin says she sticks to “business as usual,” a diversified portfolio with some other income-producing investments.

“Markets are cyclical and people still need access to the growth opportunities that equities provide,” she says.

The same strategy is easily applied to someone who’s been packaged out, because they normally leave their jobs with a large lump sum of cash. Many downsized workers move quickly to lesser-paying jobs, which creates the advantage of having at least some income flowing into the household. In either case, the advisor must play a role in helping clients understand their new economic realities.

GETTING TRIM

Do your clients have too much money going out the door? Teach them to learn the difference between necessary and discretionary spending. **[NEXT]**

The easiest way to prod clients on debt reduction is to track spending and then point out specific places where too much is going out the door. Few people have a handle on how much they spend

[TAKE NOTE]

Click here to add your own notes that you can save or print.

SIMPLE SOLUTIONS

BY

PHILIP PORADO

Little things mean a lot, and that's never truer than when it comes to saving money.

Advisors we talked with had a variety of ideas for day-to-day savings that can add up for clients. Consider these suggestions to engage clients in conversations about how they can save:

- › Pay bills on time. Companies provide customers with a late-payment option for one simple reason: They make money when customers don't pay immediately. A client can pocket money by being better organized and keeping enough cash on hand to pay the full bill amount;
- › Pay down debt. Carrying costs are a burden to almost every family. Reducing them ensures more money ulti-

mately stays in the client's pocket;

- › Build, and maintain a cushion. Bank fees are reduced, and even rebated, to customers who keep minimum balances. When the fee disappears, have the client note the reduction on the statement and allocate that money to savings every month;
- › Hit the library and save \$15-to-\$20 on subway reading;
- › Bring lunch to work, because \$5 a day or more adds up. Bring your own drink, and save an extra dollar or two a day. And, while you're at it, eat out two or three fewer times a week; and
- › Shop around. Whether it's the price of a shirt, shoes, or a litre of gas, retailers are competing for customer dollars.

Most importantly, make sure clients actually move the money they're not spending on these daily costs into a savings account or similar vehicle [see "Saving Your Clients"]. If they take the money out of their wallets and put it where it can't be touched, it will be there when they're ready to invest.

Finally, don't overlook the TFSA. Statistics Canada finds contributions to these vehicles are picking up steam. Clients who are serious about putting money away to invest can start by maxing out these instruments. While some derided the \$5,000 annual contribution cap, it's wise to advise clients that this is an annual option. In three years, it's \$15,000, in five years \$25,000 and so forth. The money adds up. —P.P.

on gifts, because such purchases are unscheduled and tend to be motivated by a desire to impress the recipient.

"I try to take the judgment away from it," notes Cavallin. "I start by giving them a cash flow sheet that has all the expense titles on it and asking them to fill that in. This gives them a handle on what they're spending."

Cars, lunches out, non-essential clothing items, drinks, and so forth should all get their own line items. And frequency of purchases must be noted.

The exercise leads to clients finding reasonable places to start adjusting their spending downward. "Yes, it's kind of scary and nobody wants to do it," Cavallin says. "But the reward is greater peace of mind and knowing you're stopping the bleeding. That feeling of control is worth a lot."

And, somehow, advisors have to snap people out of the notion that they should chase returns. James says he's sat down with clients who were getting excellent returns but still couldn't afford their lifestyles.

"People are very coachable, but they have to do things to make improvements, and accept the advice," he says. "And people have to come up with their own definitions of success. Having two cars is a luxury, despite what the media tells you."

Van Ryzewyk agrees this kind of spending behaviour can manifest in bad investment choices, especially among clients who believe they have a long time horizon.

"People say, 'I don't need the money for 30 years,' but then you have to factor in that indiscriminate spending as

well as volatile employment situations, and economies," he says. "It used to be that the biggest purchase was the house, but now people can blow themselves up with bad financial instruments that hurt them worse."

Advisors need to monitor this, advise against it, and help people "buy solutions" that get good returns at lower risk levels. Doing this, van Ryzewyk stresses, turns the tables for advisors on the liability and suitability fronts.

SELF-TITHING

Clients need to make saving a priority. That can start with something as simple as a commitment to set aside a specific sum every month. Advisors, for their part, should look at offering clients simpler investment options. **[NEXT]**

James concedes it's tough getting

clients to understand the nature of their own purchasing habits. When he looks at client portfolios, he sees the vast majority of client dollars going toward consumption, which he defines as money spent on manufactured needs beyond food, clothing and shelter.

A simple solution is to put savings dollars first, and then let those translate into investment dollars. “If people just pretended there was a 10% tax increase and socked that money away,” says James, “fewer people would have the financial angst they have today,” he says [see “Saving Your Clients”].

In some cases, properly aligning client needs may dictate some reduced compensation for advisors. Strapped

clients need to be in more secure instruments, and for some GICs, cash and bonds are the only choice. That won’t generate tons of commissions, but lean times may lead advisors to realize some of the most important work they do is the stuff they don’t get paid for.

Robert Frances, president and CEO of PEAK Financial Group in Montreal, stresses advisors need to take pride in simplicity, especially when dealing with overextended clients.

“Clients are running after trouble, and advisors make it complex,” he says. “They feel like they’re not doing enough for their clients if they don’t try something new. “But people are attracted to simplicity.”

FUTURE SHOCK

Advisors need to examine client holdings and lending agreements to see if they’re overexposed to credit.

Cavallin and James both express concern over what may happen if interest rates trend up during an economic recovery. So many clients, they say, bought a lot of goods based on the assumption that mortgage rates would stay below 5%.

“If we have a 2% mortgage rate hike, we’re going to see an explosion of people who can’t manage their cash flow,” says James. “People think it’s a good idea to max their RRSPs, but it’s not as if that’s preventing them from paying off an 18% credit card.”

SAVING YOUR CLIENTS

BY

STEPHANIE HOLMES-WINTON, an advisor with The Money Finder in Halifax.

Money for the rainy-day account should be treated like any other bill.

Why is it so many of our clients tell us they’re trying to save money but don’t succeed? From where I sit, it’s often because they wait until the end of the month and then attempt to save what’s left over.

With the possible exception of the independently wealthy, who could withstand several 2008-like markets without missing a beat, everyone should save something every month. So if you want to help your clients find the money they need to save and invest, you’ve got to know how much comes in and where the money flows from there. Only then can you have an open, honest discussion about how to redirect some of their

cash flow to build a safety net.

Having some savings not only makes a client feel more safe and secure, it helps insure all the work you’ve done on their plan doesn’t go up in smoke the minute cash flow is temporarily slowed or shut off.

Saving also gives psychological relief from the debt devil. Clients who only pay down debt but don’t create a short-term savings pool inevitably go back into debt if a financial emergency crops up—the hot water heater breaks, or books for a college-age child are a bit more expensive than anticipated.

No matter how far out of debt the client is, he or she feels awful having to dig back in, and can even become so frustrated as to stop making an effort to get a hold on spending and debt. Preventing that return-to-debt feeling truly benefits your clients’ psyche and makes them feel accomplished.

If you’ve never talked with clients

about monthly savings, it can be a difficult conversation to start. Here are a few tips:

- › Make savings a bill—Your clients have bills; none of them negotiate with their hydro companies every month. Have them put themselves on the priority list and treat their savings with the same urgency as any other monthly bill. Make the transfer of money into a savings account one more thing on the to-do list for every, or every other, payday.
- › Stop kidding yourselves—Clients and advisors alike often think certain things are expected of them. Many parents feel they must pay out large sums (when compared to their incomes) for a child’s sports program because all the other parents do it. What they don’t realize is that some of those other parents can’t afford it either. Parents believe their children deserve the world and want to give



If people just pretended there was a 10% tax increase and socked that money away, fewer people would have the financial angst they have today.

them every opportunity. But sometimes they fail to understand the opportunities they might be robbing their children of when they do things they can't afford. Overspending comes back to haunt the whole family. Help clients prioritize these emotionally charged expenses. If sports truly are important, but the clients can't really afford the costs, then dollars need to be taken from other allocations, such as the vacation fund.

- › Be a control freak—People are always telling me they can't cut spending, but only in rare cases have I found this to be accurate. If your clients can learn which expenses they have control of, they can make better decisions and pay for the things they value most. I have my clients write down all their variable and discretionary expenses. I define variable as things clients need but over which they can exercise some control (gas, groceries, clothing, haircuts) and discretionary as things that could in theory be removed from the client's vocabulary (vacations, eating out, movies, music, DVDs). To help a client control a variable expense, have him or her use a set amount of cash for groceries during a single week and buy nothing more when that money is gone. To manage a discretionary expense like a vacation, have the client top up monthly savings by the total vacation

budget divided by 12; doing this helps the client know the money will be there when it's needed. These two exercises can reduce the family grocery budget substantially without sacrificing anyone's health, and ensure a well-deserved vacation.

- › Take hands out of their pockets—The place I most often find room for savings is in clients' credit cards, lines of credit, mortgages or car loan statements. Many clients have insurance tacked onto everything and if you don't ask clients about debt and cash flow issues you'll never find these expenses. In many cases, clients are paying an extra \$100 per month to creditor insurance. Eliminating those bills is found money the client can put to work.

It's not about making your clients do anything or lose anything. You're not going to tell them what they can, or can't, have. But you do have to show them their own financial realities and help them learn to limit spending in conscious ways.

Clients can learn to prioritize what they really want from their money and bypass the stuff that didn't matter in the first place.

It only takes some small, initial progress to show people what they're capable of. If you help them get on track, they'll forever thank you for shedding some light into their wallets. —S.H.

James says there's nothing more liberating for clients than having more cash coming in than going out. But he's worried most new advisors aren't learning those simple truths, adding there's no question financial problems are significant contributors to health and relationship problems.

There's also concern among many advisors and industry observers that investors have been spoiled by how fast the equity markets have rallied back. They've forgotten the gut wrench of last fall, or the despair of March. That being the case, if a client's lifestyle is excessive, the advisor must speak up.

It clearly wasn't a good strategy for people to use their houses as ATMs. As clients wake up to that idea, they'll come to accept some basic truths like, yes, we should pay the bills on time, and if something sounds too good to be true, then it probably is.

"We're learning all those things that our moms and dads knew, but that our generation was able to miss by low interest rates," says Cavallin. "The fact that people are dealing with the mistakes of others will bring the simpler financial structures back into fashion." ^{AE}

LET'S REVIEW

To help clients reduce debt and save for the future, we looked at:

- › How to level with clients;
- › How retirees teach lessons in living on limited funds;
- › Ways to help clients trim expenses;
- › Teaching clients to save upfront; and
- › What interest rate changes could bring.