ZEN WEALTH

FINANCIAL FREEDOM AND SECURITY

How do we add value to your Financial Plans?

The Retail Distribution Review has brought greater clarity for clients on the fees that they pay for the services of a Financial Adviser. Unsurprisingly, they want to know that they are receiving good value for their money.

The value proposition for advisers has always been difficult to define. In a sense, that is unsurprising, as value is a subjective assessment and necessarily varies from individual to individual.

Although some of the strategies we describe here could be expected to yield an annual benefit – such as reducing expected investment costs or taxes – the most significant opportunities to add value do not present themselves consistently, but intermittently over the years, and often during periods of either market stress or euphoria.

These opportunities can pique an investor's fear or greed, tempting him or her to abandon a well thought out investment plan. In such circumstances, we may have the opportunity to add a significant amount of value to a client's financial plan and may more than offset years of advisory fees.

And while the value of this wealth creation is certainly real, the difference in our clients' performance if they stay invested according to our plan, as opposed to abandoning it, does not show up on any client statement.

An infinite number of alternate histories might have happened had we made different decisions; yet, we only measure and/or monitor the implemented decision and outcome, even though the other histories were real alternatives.
For instance, most client statements don't keep track of the benefits of us talking our clients into "staying the course" in the midst of a bear market or convincing them to rebalance when it doesn't "feel" like the right thing to do at the time.

We don't measure and show these other outcomes, but their value and impact on our clients' wealth creation is very real, nonetheless.
This document, seeks to identify the services that Zen Wealth provide to their clients and to explain the benefits that are brought to the client's financial plan.

Creating your Financial Plan

We will meet with you to discuss your requirements. With your agreement, we will prepare a cash-flow model and current situation report that will outline your current financial position, highlight your future objectives and consider your attitude to risk.

We will then analyse your current position and based on our extensive knowledge of financial markets, we will diligently research potential solutions for your needs.

We offer advice on an "Independent" basis. This means that we provide unbiased, unrestricted advice based on a comprehensive and fair analysis of the relevant market, giving due consideration to the full range of retail investment, pension and life products available in the marketplace which may be suitable for you.

When we have all the information we require, a full Financial Planning Report will be devised to paint a clear picture of your current position and outline a clear and thoroughly researched recommendation for the solution we believe to be in your best interests.

Should we need to consult with any professional advisers or financial services providers with whom you have an agreement, we will ask for your express consent to do so.

Setting your Asset Allocation Strategy

It is widely accepted that strategic asset allocation – i.e. the setting of long-term allocations between equities, bonds, cash and other asset classes and the subsequent adherence to these weightings – is the most important driver of long-term performance and volatility.

Setting the correct asset allocation is therefore a fundamentally important foundation of investment success. In order to set the right asset allocation, we have detailed conversations with you about your goals, as well as your financial situation, risk tolerance, contribution and spending levels, and time horizon.

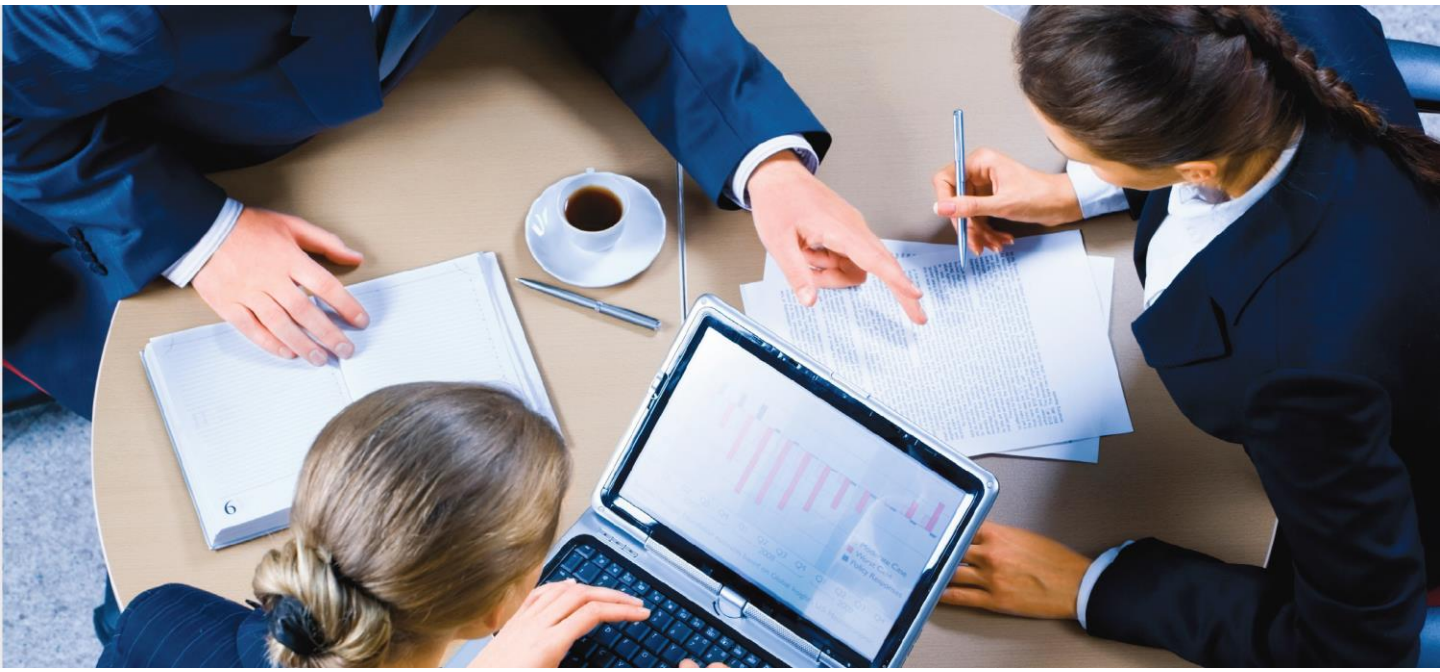
We have created an investment policy statement, which helps to crystallise these questions, as well as highlighting any other factors, such as ethical considerations, which might affect how to implement a strategy. But, as well as providing a solid foundation for sensible investment decisions, the investment policy statement sows the seed for future behavioural coaching opportunities.

For example, perhaps following a period of strong performance, you could be tempted to increase risk in your portfolios. Alternatively, in times of heightened uncertainty you may wish to retreat into lower-risk assets. Having a clearly set out investment policy will allow us to protect you against these common behavioural pitfalls and encourage you to stick with your original plan.

Implementing your Plan

Once you feel that you are in a position to make a fully informed decision to proceed and you have given us your consent to do so, we will begin the process of implementing our recommendations.

We will assist you in completing all of the relevant forms and ensuring your applications are processed by the relevant investment houses and providers in a timely manner.



On-going management

As a rule, our ongoing management service will provide the following:

Annual Reviews

The offer of a face to face, web, or telephone review meeting at least annually, which we will contact you to arrange. The review will include a review of your circumstances, goals and investment performance, together with a review of your attitude to risk and capacity for loss, to identify changes in your profile and to confirm the ongoing appropriateness of your portfolio against your attitude to risk.

Annual Rebalancing

An annual rebalancing of your portfolio, if required. Having taken the time to set the appropriate asset allocation, the next area where we seek to add value is by regularly rebalancing to that weighting. Because different assets perform differently, the initial weighting will drift over time. Typically, because equities outperform bonds over the long term, the equity weighting would be likely to increase at the expense of bonds. And because equities are riskier than bonds, the result is a portfolio that is riskier, than we would had originally planned.

Regularly rebalancing can help to correct portfolio drift as well as provide a chance for us to reiterate the importance of discipline. For many investors rebalancing in this way seems counterintuitive: after all, it means taking money out of what is performing well and allocating it to assets that are not performing so well. Left to their own devices, most investors will not do this, making rebalancing a key area where we can add value.

It's important to stress that rebalancing is designed to control risk, not maximise returns. If the goal were to maximise returns over the long term, it would be logical to keep the portfolio invested 100% in risky assets – an approach that most investors would find unpalatable.

So, regular rebalancing, perhaps timed to follow our annual review to check that your goals haven't changed, will help us to add value.

Cost-effective implementation

Cost-effective implementation is another critical component of our proposition and it's based on simple arithmetic: gross return, minus costs = net return.

Every pound paid in charges is a pound off your potential returns – and that's true in up markets and down. Moreover, just like returns, costs compound over time. So, creating a cost-effective portfolio on day one could really reap rewards over the long-term.

This fact has been repeatedly illustrated in industry research showing that low-cost funds outperform higher-cost alternatives.*

*see, for example, "the case for Index Fund Investing for UK Investors", Westaway et al, 2014.

Behavioural Coaching

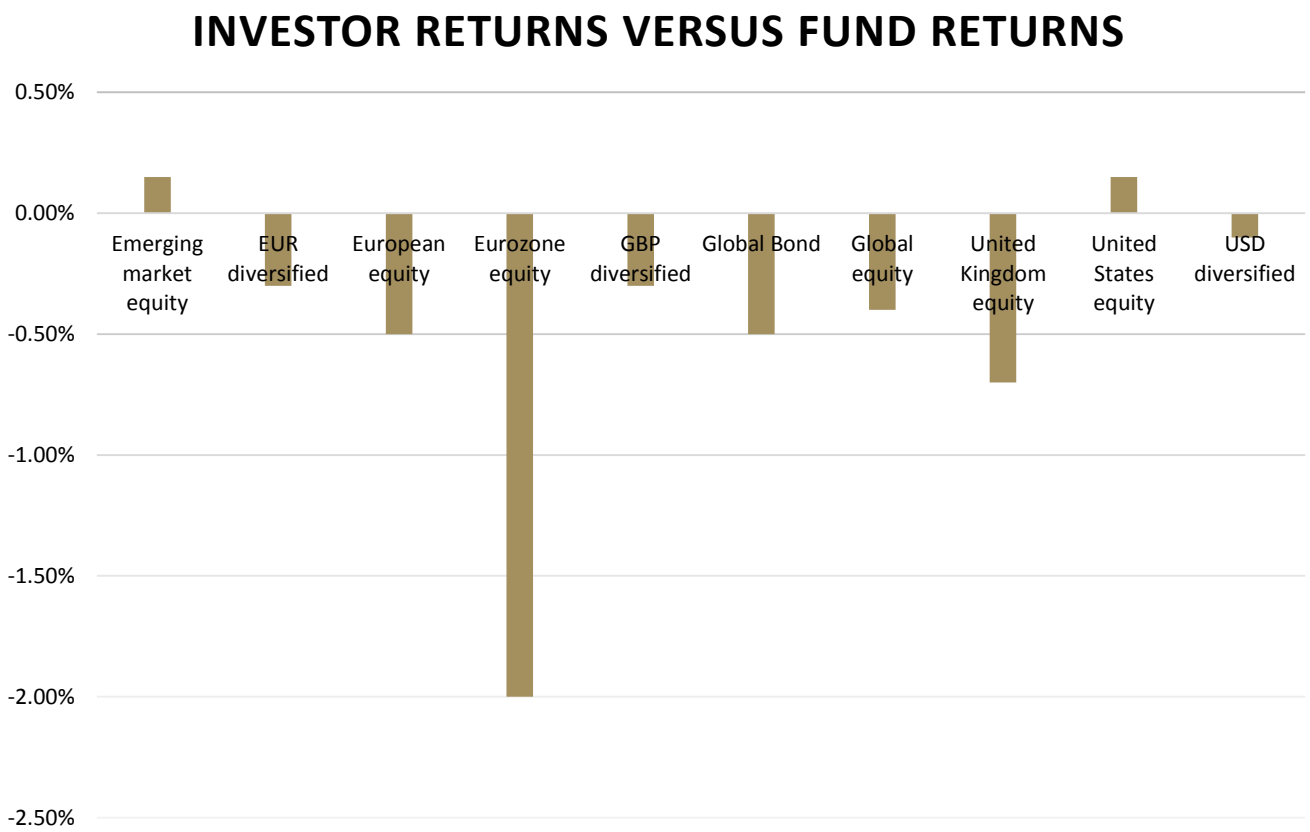
Most investors understand the importance of remaining disciplined at times of heightened uncertainty. However, very few succeed in staying calm in turbulent markets. Indeed, many end up taking exactly the wrong course of action.

Behavioural pitfalls such as trying to time the markets or chase performance are among the biggest destroyers of wealth. That's why behavioural coaching is probably the most important area where we try to create value for our clients.

In order to do this, we go back to the original plan that we created with you. In order to do this, we go back to the original plan that we created with you. This helps us to remind you of the original plan of action and will allow you to put emotions to one side when markets get tough. These market conditions are thankfully fairly rare over the long term but, when they do happen, they can be significant.

By helping our clients to avoid destroying their wealth through common behavioral pitfalls, we could easily repay our fees several times over.

So, how much value can we add in this way? Many academic studies have concluded that behavioural coaching can add between 1.00% to 2.00% to your Portfolio's performance each year. Another way of estimating the value from behavioural coaching is to compare the returns generated by a fund with the returns experienced by the average investor in the same fund. This shows how much value investors destroy on average by trying to time the market. This figure varies by market, with some categories around 1% per annum and others approaching 2%, as shown below.



Notes: Figure displays the difference between the investor and fund returns, as defined by the asset-weighted average in each category. Investor returns are calculated as the internal rate of return that sets the beginning and ending fund assets equal, given the interim cash flows. Market returns are the asset-weighted average fund return. Both are derived from aggregate flows data for funds domiciled in the UK, with asset classes defined as in Westaway et al (2014). Returns are in GBP, net of fees, with income reinvested.

Sources: Vanguard calculations, based on data from Morningstar, Inc. Ten years ending 31 December 2013

Use of tax allowances

The allocation of assets between taxable and tax advantaged accounts – sometimes referred to as wrapper location – is another important tool that we use that can add value each year. What's more, just like minimising costs, the benefits of investing tax-efficiently will compound over time. Optimal portfolio construction from a tax perspective might involve holding tax-efficient broad-market equity investments in taxable accounts, while broad market bonds are held in tax-advantaged accounts such as ISAs and pensions.

This arrangement takes maximum advantage of the different tax treatments of the two asset classes.

Use of a spending strategy

The number of retirees is rising rapidly; many investors have both taxable and non-taxable investments and budget changes have increased the financial options open to the recently retired. In this environment, we can add significant value by ensuring that post-retirement spending is undertaken as tax-efficiently as possible.

Let's look at a hypothetical example. Consider a higher-rate taxpayer with a portfolio that is invested 60% in equities and 40% in bonds and split evenly between taxable and non-taxable investments. If this client wishes to withdraw 4% of the portfolio each year, the order in which he or she makes those withdrawals will have a big impact on the rate of tax they pay. This, in turn, will affect the long-term returns that the portfolio will generate.

Spend from taxable accounts first.

For example, if our hypothetical client draws down the taxable portfolio first, an increasing proportion of the remaining portfolio will be tax-sheltered. Thanks to its favourable tax treatment, this remaining portfolio will subsequently grow faster than the starting portfolio, half of which was being taxed.

Of course, without taxes, or without the wish to withdraw, the scope to add value in this area disappears. But, for clients who do have tax liabilities and who wish to make withdrawals, sound advice can make a real difference.

For example, a client with a £250,000 portfolio who is within the capital gains allowance and only has 20% of the portfolio in taxable accounts could still generate savings of 0.29% per annum by spending in a tax-efficient way.

Use of a total return strategy

Historically, investors holding a diversified portfolio of equities and bonds could quite easily generate a healthy income from their investments, but not anymore. With yields on low-risk government bonds at historic lows and likely to stay that way for the foreseeable future, we can create significant value by offering advice on how to address the income conundrum.

There are three basic options for clients whose portfolio income falls short of their spending plans:-

1. They can spend less;
2. They can reallocate their portfolios towards higher-yielding investments; or
3. They can spend from the total return of their portfolio, which includes capital appreciation as well as income.

We aim to help our clients to make the right choices in this regard. Bear in mind that, for many investors, moving away from a broadly diversified portfolio may place their investments at greater capital risk than actually spending from capital.

For example, four common approaches to boost portfolio income are to:

1. Increase weightings to longer-duration bonds;
2. Invest in higher-yielding, credit-sensitive bonds;
3. Allocate some of the bond weighting to income generating equities; or
4. Allocate some of the broad equity weighting to higher dividend yielding equities.

Each of these approaches carries its own potential dangers. Longer-duration bonds, for instance, are typically more susceptible to capital losses when interest rates rise.

Meanwhile, higher-yielding bonds carry greater credit risk than government bonds and can exhibit high levels of price volatility in times of market stress, greatly reducing the diversification benefits of holding fixed income alongside equities.

The third option, moving some of the bond portfolio to high-yielding equities, can substantially alter the risk profile of the portfolio, potentially exposing your investments to much higher levels of capital risk than those set out in the original plan.

Finally, moving some of the broad equity exposure into higher dividend yielding equities will skew the equity allocation towards certain income-generating sectors, reducing diversification and potentially increasing risk.

We prefer to adopt a total return approach, rather than pursuing any of these four paths i.e. one that focuses on both income and capital appreciation.

Such an approach has the advantages of maintaining the originally agreed-upon asset allocation; allowing greater flexibility from an asset location and tax efficiency perspective and controlling risk by ensuring maximum diversification.

The amount of value that we can add by employing a tax-efficient total-return strategy for you will vary according to the size and breakdown of your portfolios and your spending needs. However, it is likely to be significant for many of our clients.

Fees, payments, and service terms

Service	Fees	Service Terms	Payment Schedule	Primary Contact at Zen Wealth LLP
Creation of your Financial Plan	£1,500.00 plus VAT (if applicable) - fixed fee.	If implementation proceeds, the fee for preparing the cash flow model and current situation report will be waived.	Invoices are issued within 10 days of an advice service being finalised and/or presented.	Patrick Murphy
Implementation of Solutions	Up to 3%, subject to minimum fee of £1,500.	A sliding scale of fees applies, meaning that the relevant fee or fee percentage is applied progressively.	Invoices are issued within 10 days of your product/s being commenced.	Patrick Murphy
On-going Management	1% of portfolio value, subject to a minimum annual fee of £1,500	Fees paid in respect of our on-going services may be cancelled upon request	Fees can be paid by annual / monthly deduction from your investment, or by annual / monthly Direct Debit	Patrick Murphy

Accurate information

This document should be read in conjunction with our standard Terms of Engagement, upon which we intend to rely. For your own benefit and protection, you should read these terms carefully. If you do not understand any point please ask for further information.

Privacy statement

You may be assured that we and any company associated with us will treat all personal data and sensitive personal data as confidential and will not process it other than for a legitimate purpose.

Ownership

Our fees are based wholly upon the provision of our qualified and professional expertise; the time taken to analyse your circumstances and devise an appropriate strategy going forward; the design of an appropriate summary report to communicate this strategy to you; and also takes into account our firms exposure to regulatory, commercial and financial risk.

Should we undertake initial research towards your goals, but you subsequently do not proceed with our recommendations; we will raise an invoice for an agreed fee in order to recoup our costs.

Regulatory Statement

Zen Wealth LLP is a Chartered firm of financial planners and a member of Best Practice IFA Group Limited, which is a network that promotes a high level of market standards through the provision of back-up resource, technology, training and support. Best Practice IFA Group Limited is authorised and regulated by the Financial Conduct Authority.
The registration number is 223112 and a full list of members can be found on the FCA register.

Indemnity

We are covered by the Financial Services Compensation scheme (FSCS) if we cannot meet out our obligations. This is dependent upon the type of business and the circumstances of the claim. Most types of investment / pension business and mortgages are covered by 100% of the first £50,000, with deposit accounts benefiting from protection of £85,000 and insurance covered up to 90% of the claim with no upper limit. Further information about this compensation scheme arrangement is available from the FSCS.

The information on this document does not constitute legal, tax or investment advice. You must not, therefore, rely on the content of this document when making any investment decisions.
The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Past performance is not a reliable indicator of future results.

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