finweek

COLLECTIVE INSIGHT

INSIGHT INTO SA INVESTING FROM LEADING PROFESSIONALS

MAY 2020

DISRUPTING THE WORLD OF FINANCIAL ADVICE

SHIFTING TOWARDS A MODEL THAT WILL SERVE THE BEST INTERESTS OF ALL SOUTH AFRICANS

Inside

By Evan Gilbert

INTRODUCTION

Financial advice in the future

What would a model of financial advice that would serve the best interests of all South Africans (not just those with money to invest) look like in a post-Covid-19 world?

South Africa is a country of diversity – this is obviously true across many dimensions, but it is the skewed distribution of employment and wealth present in our country and its implications for the financial advice sector that is particularly important for this issue of *Collective Insight*.

It is the nature of a capitalist economy to arrange itself to serve the needs of those who can pay for them. While this system can have many beneficial outcomes for society, it is not the only way to do it. As the current experience of the US medical industry shows in its response to the Covid-19 pandemic, it can result in very haphazard and discriminatory care to citizens in times of need.

The SA financial services sector is currently arranged in a similar fashion – there is excellent support for those people who are formally employed with savings and insurance advice needs. Even so, there are some peculiarities: Higher-income clients are typically sold retirement annuities, and lower-income clients funeral and life policies.

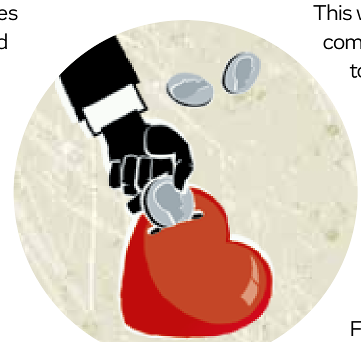

Photo: Gallo/Getty Images

The financial advice space is also a very product sales-driven industry, rather than being truly advice-led. Advisers seem to be stuck in the position of being independently employed salespeople for financial products rather than truly independent advisers focusing on helping their clients manage their financial health. While the reasons for this are varied, the current remuneration structure arrangements of the product providers are certainly significant in terms of arriving at this outcome.

The unfortunate implication of this approach is that there is no easy answer to the following question: How do you provide a service to a person who needs it very much, but has very little money to either pay for it or invest in products that will generate a fee for the adviser? In short, the financial advice system in this country is currently a very haphazard and fundamentally skewed system, providing only partially for the financial needs of their existing clients and effectively nothing for the financial needs of large parts of South African society.

Given the importance of financial health for an entire society, we set our contributors the challenge of re-imagining the SA financial advice industry with the goal of overcoming these discriminatory outcomes. Unfortunately, this challenge turned out to be a step too far for most of our contributors. While this edition will show that there were some interesting and insightful contributions, the vast majority of the submissions consisted of proposing effectively minor tweaks to the current system.

This was very disappointing for the committee and so we have decided to do something slightly different in this edition. We have decided to use it to focus more on the key issues that have been identified in the SA financial advice industry that need to be resolved. The challenges and barriers to achieving this change will also be discussed. Finally, some of the proposals for change received will be presented.

This edition will be the precursor to a live roundtable discussion where possible solutions to these problems will be discussed with all the relevant role players being invited to contribute.

With this in mind, we start with Deslin Naidoo's comparison of the medical and financial advisory industries, which provides an illuminating perspective on how the latter can be changed to achieve some of the similar benefits for society that the former provides. This is an excellent example of a different perspective on the industry that could lead to significant improvements in its impact on society.

Two contributions then highlight the financial advice needs of most South Africans that are not being addressed by the current system. By highlighting the different financial outcomes of two similar individuals driven purely by their social contexts, Abu Addae identifies the potential for the financial services sector to help overcome the perpetuation of income inequalities. He recommends a subscription-based model to make a more holistic financial advice accessible to all.

Gugulethu Siziba considers both the gaps in coverage and the issues of access to financial services for all South Africans. She then evaluates how technology can be useful to overcome both issues.

David Kop and Anne Cabot-Alletzhauser consider the barriers to change that this industry currently faces. David recommends specific changes across the entire industry ecosystem – from regulators to consumers, practitioners and product suppliers. Anne highlights the importance of the current remuneration structure, explaining its outcomes. Echoing other contributors, she emphasises the need for holistic, rather than purely investment or insurance advice and the potential for technology to help by making relevant information more easily available.

Many of the contributions received focused on the challenges of providing good investment advice. The best of these are included here. Ian Macleod highlights the importance of narratives to explain (and motivate) individuals' investment choices. He discusses how epidemiological models can be used to explain the rise and transmission of sentiment through virally transferred narratives.

Paul Nixon builds on this by using the story of Odysseus tying himself to the mast and stopping his oarsmen's ears up with beeswax as a metaphor for clients, financial advisers and asset managers having to deal with uncertainty in times of crisis. He makes the point that having a systematic plan helps them to avoid making incorrect decisions in these situations.

In a similar vein to Paul, Grant Locke explores the reasons why investors are not on track to meet their investment goals. He shows that most of the time it is the own decisions of the investor that create the problem and argues that the use of technology to provide real-time feedback on the implications of their decisions could help them avoid making bad ones.

The final contribution in this edition is by Louis van der Merwe. He looks at ways in which an employer could act as the bridge between the financial adviser and their employees. He points out that this could not only increase the level of coverage of the advice industry, it could also be a way for companies to differentiate themselves to new employees.

As you will clearly see when reading this edition, the problems facing the financial advice industry have not been solved. In fact, they have barely been spelled out. We want you to be part of the journey, so we invite you to be part of the roundtable discussion that will follow the publication of this issue.

Details of the roundtable will be circulated to all readers and everyone is encouraged to attend and to contribute. We look forward to working with you on improving this industry for itself and the good of all South Africans as we strive to improve the overall level of financial health in our country. ■

Evan Gilbert is an associate professor at USB and research analyst at Momentum Investments.

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How to contribute to *Collective Insight*

- Contributing authors can determine whether any of the suggested angles under each topic would be of interest to address – or they can elect to introduce their own angle on the specific topic. There is no restriction.
- Contributors should avoid using their contributions as marketing pieces, opinion pieces or investment recommendation pieces.
- An advisory committee selects which contributed articles to include in *Collective Insight*. Selection is on merit and suitability only and is completely unrelated to any advertising that may appear in the publication.

Please send any proposed contributions to Anne Cabot-Alletzhauser at cabota@aforbes.co.za

Theme for the next issue of *Collective Insight*

The advisory committee is calling for articles on the theme *How to better measure the value and impact of your investments* in the forthcoming *Collective Insight*. The deadline for submission is 13 July 2020.

The following topics will be considered:

- ■ Can we make use of better metrics for assessing the value and impact of our investments?
- ■ Can we ever get to a universal agreement around appropriate metrics of value-add?
- ■ Do we understand where to turn to if we want investing to have an impact on a specific aspect of South African needs?
- ■ What are investors really capturing when they invest in the JSE?
- ■ Different types of investments reflect different business models:
  - • How do you assess which business models are likely to deliver what South Africa requires, for example: short-term vs long-term investing; paying for alpha performance (outperformance); private equity vs venture capital vs impact investing?
- ■ What needs to change?

How to attend the roundtable discussions

An online roundtable discussion will be held on **3 June 2020 at 17:30.** The authors of this edition's articles will share their insights and opinions. Visit the CFA Society's website at https://cfasociety.org/southafrica/Pages/Home.aspx and look under the Events page for the online roundtable discussion.

By Deslin Naidoo

FRAMEWORKS

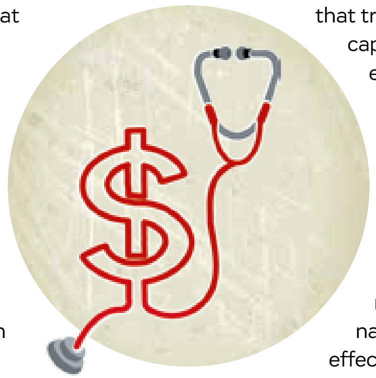
Lessons from the ‘Wolves of Groote Schuur’

Aligning financial advisers’ roles in a similar way to the medical profession may deliver better results for clients.

Why is it that doctors have not yet *earned* the title “The Wolves of Groote Schuur”? Is the differentiating element the perception of care?

Financial advice seems to be geared towards those that have money; and if you do not, then the profession has little vested interest in you. It seems blindingly obvious that we are missing a trick to reach people when it comes to financial advice. Rather than being practical, relevant, and accessible, we have created an industry that has an aloof yet in-your-face personality.

Financial health is as relevant as medical health. It makes sense to recognise that if your citizens are not able to be financially independent, or productive enough to be self-sufficient, the burden on the social system will be more than can be managed. The economic and social ramifications can far outstrip the costs of medical care, or pension shortfalls that arise due to longevity. Social unhappiness due to financial inequality is most relevant when large portions of society are not financially self-sufficient and the means to become so are not available.



Lesson one: Financial healthcare must be a daily activity

Healthcare globally is organised across three tiers – defined as primary, secondary and tertiary healthcare. The underlying principles defining each tier, the purpose, and the associated role players, can be used to define the parallel framework to deliver financial health across a country – particularly those where large parts of the population are not financially equipped.

Let us not argue the efficacy of delivering this, but rather focus on the principle that belies it. At a primary tier level, the focus is about access and this means integrating financial health into people’s daily lives. This includes (but is not restricted to) activities such as financial literacy; access to financial planning tools; core banking services; relevant core financial products; individual services for financial soundness such as tax advice and debt management; wills and estate planning; and accessibility to grants and loans.

Secondary and tertiary financial healthcare deals with less common and more complex problems that one would face. Solving these issues requires more specific skills and would require the individual to be appropriately referred from practitioners in the primary tier to more specialised practitioners.

Suitability, appropriateness of service and affordability of fees are relevant elements within this tier. Like scheduled drugs, access to services should protect individuals from abuses and other dangers. Technology and advertising, which have democratised services such as financial speculation and option-based trading to individuals not equipped to manage the associated risks, would be better regulated.

Lesson two: Treat the patient holistically

Financial advice is currently skewed, almost obsessively, towards investments and insurance. Practitioners themselves know this, but unfortunately it is how financial rewards are structured. To make financial advice practical, accessible and holistic, its definition must evolve. The purpose of financial advice is to provide a prudent, understandable, and executable plan that firstly encompasses both financial assets and human capital; secondly optimises the trade-offs between consumption, savings and risk; and, finally, is placed in the context of the individual’s aspirations and their responsibilities to a household.

This changes the way you look at the problem. The power of compounding is a popular argument promoted in the industry to encourage young people to start early to save for retirement. If you contextualised this with the value of human capital, financial modelling would reject the argument. It is of greater value for an individual to continue to invest in growing their human capital.

Similarly, one can model other financial scenarios that prove that traditional financial advice, in the absence of human capital advancement, leads to poorer outcomes. If this is expanded from individuals to households, with inter-generational effects, it starts to explain wealth gaps and financial inequality.

Lesson three: We all know what doctors, nurses and pharmacists do

There is no standardisation of roles across financial services practitioners. It is an individual choice, and regulation relies on disclosure to protect the public. It is naïve to believe that specialised practitioners can provide effective advice from a narrow base. As the industry moves towards an advice-fee model (non-commission), it becomes imperative that the industry evolves toward general practitioners that have a holistic foundation.

The requirements of the Financial Advisory and Intermediary Services (FAIS) legislation must be reviewed, advocating that all practitioners are qualified generalists before allowing financial specialisations. These general practitioners operate in the primary tier, under a limited product and service model, referring more complex problems to specialists. Alternate qualifications for pre-defined functional or support industry roles, as with nurses and pharmacists, can be structured alongside this.

Beyond policy and regulation, government has an enablement role, as self-care is a big element for success. Financial health, like medical health, needs to be introduced early in one’s education process. This is then augmented by access to tools and information.

Clinics play such a role in healthcare; libraries and post offices can be retooled to do the same, subsidised through the issue of social impact bonds. Banks and employer benefit schemes can play a significant role in financial literacy and access to practitioners. Robo-advisers must evolve from risk-profiling and fund-matching algorithms towards more integrated financial modelling.

There is without doubt many technical complexities that need to be debated, but I challenge the thinkers in our industry to seek solutions that can build on the principles of this framework. ■

Deslin Naidoo, CFA, is the founder of NEBULA SI, a savings and investment start-up integrating traditional finance with artificial intelligence.

Photo: Gallo/Getty Images

By Abu Addae

DISRUPTION

How to shake off inequality

The Covid-19 crisis has highlighted that the current financial system is not set up to help ordinary South Africans – many of whom are already held back by family circumstances and the burden of black tax.

If Covid-19 is teaching us anything, it is how little financial resilience there is among the general population of South Africa.

Personal finances remain in a perpetually precarious state. The current financial system is not set up to help ordinary people. Sure, you can get easy access to credit at exorbitantly high interest rates, but it's much harder to get proper advice on how to manage that debt, or how to get ahead in life more generally.

This is true for traditional financial services globally, but even before Covid-19, South Africans already had to contend with more than most: a broken economy, rolling blackouts and a weakened currency. Then there's the hidden burden of 'family tax' or 'black tax', which sees many people working hard and earning well, yet struggling to thrive because of responsibilities for ageing parents or family members that are dependent on them.

By some estimates, as many as 80% of first-generation middle-class earners are paying, or have paid, some form of black tax, and it consumes between 10% and 25% of their income.

A tale of two circumstances

Looking at two typical SA stories illustrates how the black tax burden plays out in people's lives. Take Kagiso and Loyiso: Two young men equal in talent, education, and work ethic, but with quite different starting points.

Kagiso gets his first car as a hand-me-down from his father, is on his parents' medical aid until after university, and gets help so that he pays lower-than-market rent when he starts working. He also gets support in securing his first property. Loyiso, on the other hand, leaves university with a student loan, must put his parents and sister on his medical aid, and commits a chunk of his first paycheck to helping his sister complete her studies. He sends money home to his parents every month.

These early circumstances gather momentum to define their financial futures. Because of his more privileged start, Kagiso finds himself in a position to take more risks in his career. He starts a successful business in his mid-30s and can leverage this wealth by investing in property and his retirement. Loyiso is never able to take any significant risks. He is saddled with student loan debt, contributing to family funerals, and supporting ageing parents, while juggling his own responsibilities and paying off a car.

To put this into numbers, a 10% to 20% black tax deficit means it will take you five years longer to buy your first property, and when you do, it will be in an area

25%

lower in value than your unburdened peers.

Fast-forward a generation and it's plain to see why SA has such high and persistent levels of inequality. Kagiso's children are property owners while Loyiso's children are tenants who must support their father. Wealth flows backwards rather than forward through the generations and social mobility is painfully low. Even with a good education, South Africans are highly likely to end up where their parents were.

To put this into numbers, a 10% to 20% black tax deficit means it will take you five years longer to buy your first property, and when you do, it will be in an area 25% lower in value than your unburdened peers. You will need to work seven years longer to enjoy the same lifestyle they do, and you'll have 60% less wealth to give your kids a good start in life.

Your margin for error is much narrower, too. If you have a financial setback – for example, a failed business that costs you R300 000 – it will take you five years longer to recover. You'll have to work well into your 80s to make up the difference, with a strong possibility of ending up in a debt spiral along the way, and pass on black tax to the next generation.

It's not difficult to see how the current economic crisis is going to further disadvantage Loyiso.

Ripe for disruption

For SA's economy to unshackle itself from its entrenched inequality, we need to look beyond macroeconomics and start focusing on people's personal finances.

The financial services industry is ripe for disruption. It currently caters for those who already have wealth, while ignoring those who need advice the most. And the problem lies at the very core of the traditional business model: Financial advisers make money from selling products, and products can only be bought by those who have money.

The challenge facing us is to cater for the mass and middle-income market segments in a way that mimics the bespoke and independent advice reserved for the ultra-wealthy. In effect, we need to focus on helping people make the right life decisions that ultimately lead to the creation of wealth; the career, lifestyle and business decisions that shift a person's trajectory.

This demands a radical new way of thinking about financial advice – and, indeed, our clients. Instead of classifying somebody like Loyiso based on his current circumstances, we should be looking past these to what he can become.

Creating a sustainable business model

Making this model sustainable from a business point of view isn't easy. Sometimes the important advice for Loyiso is that he needs to pay off his debt first or find a side hustle or borrow to fund his MBA.

Financial advice will need to be marketed in a way that convinces people to sign up and pay a monthly fee for advice. To do this, the service will need to deliver tangible value for the client over the long term, and at low cost.

Fintech can help solve the problem of economies of scale because it can reduce the time it takes to give every customer a personalised financial plan and provide high-quality and consistent advice every single time. It also allows you to empower clients to take charge of how they explore and interact with that advice.

Of course, sound financial advice cannot be left to technology alone. When people interact with stressful decisions like finances, empathy is an important factor to eliminate translation errors between man and machine. More importantly, financial plans demand sacrifice, and people need an accountability partner to help them stick to it. Technology isn't great at driving behaviour change over the long term, but a trusted adviser might be.

But the human factor should be used when it makes a difference, allowing the machine to take care of the rest. The future of advice is in leveraging the best of both worlds.

In this new approach, a monthly subscription fee of a few hundred rand – multiplied over a decade – starts to look like a sustainable model. And for someone like Loyiso, it means a small monthly investment in his ideal future, at less than the cost of a gym contract.

The current crisis has highlighted the vast inequalities in this country; it has also highlighted the urgency for innovation in the financial services industry. If we don't manage to create a model that provides more South Africans with fair and wise advice, we will never shake off the persistent inequality that dogs this country. ■

Abu Addae is the co-founder and CEO of LifeCheq.

ACCESSIBILITY

By Gugulethu Siziba

Finding scaling solutions for the masses

Focusing on the underserviced portion of the economy needs a robust reimagining.

The mindset of 'making your money work for you and not just working for your money' is difficult to embrace for most people in South Africa living from one paycheck to the next.

According to the *Allianz Global Wealth Report 2019*, approximately 10% of SA's population is classified as middle class and earns more than R10 225 per month – a figure considered barely feasible to provide for one's needs in the present, let alone setting aside for the future. The other 90% of the population is in dire need of good financial advice and cannot access it because they cannot afford it or don't have enough to invest.

The financial advice they do receive isn't holistic and is directed towards savings, life assurance or funeral cover needs and less so towards debt management and budgeting. A reason for this is that financial advisers do not make money from budgeting or debt management.

At the 2018 Morningstar Investment Conference, Alexander Forbes' head of research, Anne Cabot-Alletzhauser, said that "up to now, the role of financial planning had been centred on the idea that if you stick to a financial plan and achieve it, everything else will fall into place, but this is not so". The role of the financial adviser of the future will not be about picking the best investments for you, but rather helping you improve your financial capability, she said.

There is undoubtedly a need to get good, holistic financial advice and education to the masses and fintech could provide some of what is required.

Has fintech already improved access to financial advice?

Fintech has been researched and implemented to try and bridge the gap between financial advisers and the broader, less affluent population. The financial services industry has seen tremendous changes in the banking sector with the use of mobile and internet banking, and several robo-advisory platforms have also been launched but with varying success.

However, most of this technology has not managed to bring financial advice to the market it was intended to help, but rather optimised administrative processes for the minority of traditional investors who are already financially literate and engaged.

So as much as technology has had a big impact on the banking world, when it comes to good financial advice, there is still a lot more that needs to be done to find the right, scalable solution that will reach the masses. Having Google at everyone's fingertips is not enough.

Who is being left out and what are their concerns?

An informal saving structure being utilised in SA is the stokvel. According to the National Stokvel Association in SA, there are roughly 810 000 active stokvel groups consisting of over 11m members and collecting an estimated R50bn annually. To contextualise these figures, nearly 40% of SA's adult population belongs to a stokvel, according to the association.

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Photos: Gallo/Getty Images

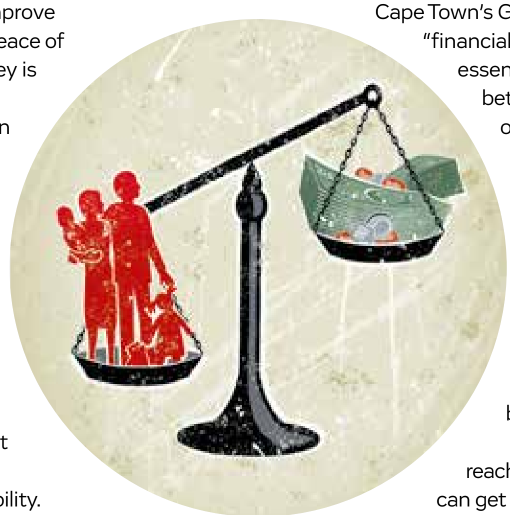
So instead of offering just traditional investment products, the solution may need to open itself up to alternative products that appeal to a broader audience.

After sitting with a group of ladies who run a stokvel, they explained that they would rather settle for informal ways of saving, investing and credit facilities because they felt deceived by the financial advice they had gotten previously.

They also noted that they would prefer to keep a close eye on their investments and manage them in a language that they understand. The interesting takeaway from my time with this stokvel was that there was undoubtedly a culture of saving already established, but the group lacked knowledge and trust to engage with a licensed financial adviser. This lack of trust is filtered down to younger generations who are also opting to settle for informal ways of saving.

Possible solution?

Given the proliferation of mobile phones in SA, any fintech solution would have to be mobile. Anyone should be able to access financial advice via a mobile device and do so in an easy-to-understand and low-cost way. Putting an adviser in their pocket will improve transparency and give people peace of mind knowing where their money is and how it is being managed.



A Deloitte report on trends in wealth management suggests that clients increasingly "want to stay in control of their financial lives and understand the advice they receive". This is even more important when addressing an undereducated mass population in rural SA.

To be easy to understand, the solution would need to meet each person wherever they are on their journey to financial stability. That means it probably also needs to be multilingual – providing guidance and education in a language that a client can understand – and provide guidance on how they can manage debt, their credit rating and draw up a budget.

Another consideration will be the products that are offered by the solution as they need to resonate with the people being served. For instance, it would be difficult for me as a black child to get my parents to invest in shares or funds that they have never heard of. Their understanding of wealth and investments is cattle, chickens and farming. So instead of offering just traditional investment products, the solution may need to open itself up to alternative products that appeal to a broader audience; and regulators may need to create new structures to govern these less formal products and the advice surrounding them.

A big challenge for a solution operating at scale will be providing personalised financial advice that considers each client's circumstances, but not at a loss to the adviser. In future, technology including artificial intelligence may hold the answer to this piece of the puzzle, but there are already ways in which some of the difficulties faced by financial advisers in providing scalable advice in a cost- and time-efficient manner are being addressed with intelligent and compliant client and adviser platforms.

Lastly, financial education should be one of the cornerstones of any solution as increasing a person's financial capacity is vital to building trust.

According to Rudzani Mulaudzi from the University of Cape Town's Graduate School of Business, the "financial education of stokvel members is essential to increase awareness of how better investment and management of the money could result in bigger benefits to members. Members need to be made aware of the power of collaboration. A targeted education programme could enable stokvel members to transition in their thinking from being consumers to being investors and therefore begin to exhibit investor attributes and behaviours."

In conclusion, financial advice can reach the masses. Every South African can get good financial advice from a solution that is a truly comprehensive financial services product. However, the financial services industry needs to be open to new ways of communicating and improve access to information so that transparent, up-to-date tools can be made available to the client. It further needs to offer more straight-through processing options for numerous financial products (thereby relieving the administrative burdens faced by service providers) and restructure old products in new ways. Finally, it needs to embrace new ways to educate remotely and be more client-centric and understand the needs and traditions of many. ■

Gugulethu Siziba is a junior financial adviser at Wealthcraft.

DEBATE

The times they are a-changing

By David Kop

There are probably hundreds of thousands of consumers who are in a better position due to the financial advice that they have been given, be it that person who could retire, or the family who was financially OK after the loss of a breadwinner.

However, times have changed and the consumer's needs for financial advice have changed with it. While some professional financial advisers and planners have moved with the times, I think that it is fair to say that the industry has not adapted fast enough. To be fair, it is not a simple matter. Financial advice is not provided in a vacuum, it is provided in an ecosystem that consists of government, consumers, practitioners and product suppliers. Change is required across the system for advice to move forward.

1. Regulation – The Retail Distribution Review is a process whereby the laws and regulations around the provision of financial advice is being reviewed. The three main areas being considered are remuneration of advisers, adviser relationships with product providers, and the services provided by financial advisers.

2. Consumers – While much focus has been on the fee chain in the financial industry, consumers need to understand that financial advice is a valuable service that has always been paid for, albeit imbedded in the cost of the product. This may have created the impression that the value lay only in the selling of a product.

3. Practitioners – My pet peeve is advisers who try and demonstrate their value proposition by putting down another adviser. This puts a negative spin on the entire advice industry. It tells consumers that financial advisers are not to be trusted, except me. For me, a financial adviser must have a client-first mentality, the business model they operate in comes second.

4. Product suppliers – One of my favourite quotes is from Denna Katz, who said we used to give away advice to sell a product, and now we do just the opposite. Product suppliers remain a large employer of financial advisers.

The current business model of remunerating on new policies needs to change. The focus should be on client relationships and retention, rather than just new business. ■

David Kop is an executive director at the Financial Planning Institute of Southern Africa.

How advice should adapt in a post-pandemic SA

By Anne Cabot-Alletzhauser

There's probably a good reason why financial advice has never been able to expand to a broader base – because the business of "wealth" management has been predicated on the notion that there was "wealth" in the first place. This means that compensation for this professional service would be based on either a fee as a percentage of assets under management or a commission embedded in the product itself – creating the illusion that they were getting the advice for free.

In a post-Covid-19 world, financial advice will be the one thing that everyone in South Africa will require. But our starting point will be from a lack of wealth. How do we start again? Here is what this much-needed service will require:

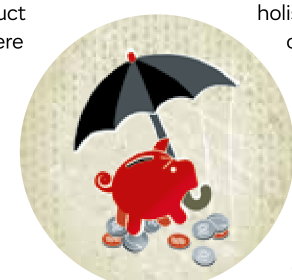


Photo: Gallo/Getty Images

▸ A new business model where advisers are compensated for helping people navigate their way back to financial stability:

- This could be embedded in an employee benefits package deducted from the contributions made by members. Financial stability is a win for employers, employees and the government – it keeps people saving, while helping them manage the financial trade-off decisions they must make over the course of their lives.
- If people are unemployed, then the cost could be carried by the UIF or a retrenchment package.
- Success must be monitored and measured.

▸ A new framework for attracting and training advisers:

- The adviser of the future is one who understands a holistic picture of the lens of responsibility of a family or income earner.
- The focus would be on trade-off decision-making around the full range of options: budgeting, job packages, savings for emergencies, retirement, health costs, housing, education, income or asset protections, taxes, and, if there is money left – investments.
- The right candidate is someone with a passion for coaching and teaching.

▸ A new technology that allows an individual to aggregate all that planning insight and financial data and carry it with them to any new employer or planner:

- Here is where blockchain could provide the key to servicing people who may be in and out of employment or moving from one employer to the next. ■

Anne Cabot-Alletzhauser is head of the Alexander Forbes Research Institute.

By Ian Macleod

ECONOMICS

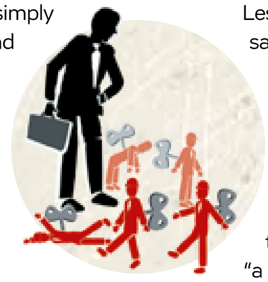
Narratives and numbers

The field of narrative economics offers a new view on how popular stories move markets.

Economics, investing and financial advice have become highly mathematical pursuits. Indeed, numerical tools and models are paramount in these arenas. But we can always do better. The new and profound lens called narrative economics has the potential to elevate financial advisers' analytical and predictive power. Spearheaded by 2013 Nobel Prize laureate Bob Shiller, this novel approach embraces the power of words.

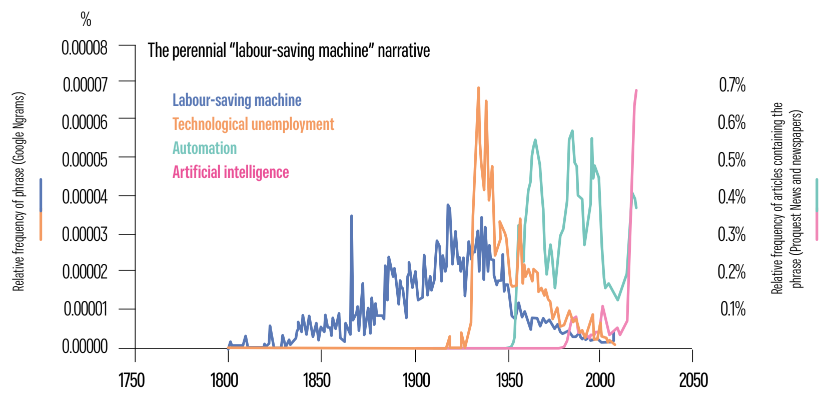
Shiller, professor of economics at Yale University, begins his argument for "a form of economics that takes narratives seriously" by demonstrating how economics and finance stand out from other faculties by their exclusion of narratives. "History, anthropology and sociology love narrative," he says, "but the worst field for the understanding of narratives is finance." The problem with this, Shiller continues, is that "it is important to learn about economic narratives because they are a fundamental driving force for the economy. We can't pretend they don't exist."

In his 2017 presidential address to the American Economic Association, he called narrative economics "the study of the spread and dynamics of popular narratives, the stories, particularly those of human interest and emotion, and how these change through time, to understand economic fluctuations." So, narratives in this context are simply stories that we hear and share, and which have some impact on our economic behaviour. Like the trending field of behavioural economics, narrative economics appreciates the whims of being human, and how that drives our actions.



One recent example of an economic narrative goes something like: We've had a very long spell of growth in America, some parts of the yield curve have inverted, so we must have a recession on the way. We've all heard it on Bloomberg. We've discussed it with friends and colleagues. It doesn't seem like a stretch to suggest many people changed their economic activities because of it (albeit that any lurking recession was intercepted by the arrival of Covid-19). Even if just the odd bit of belt-tightening here, putting off that new car purchase there, or holding back on expansion of your business, these small decisions aggregate to drive markets.

THE NARRATIVE OF MACHINES TAKING OVER HUMAN JOBS THROUGH MULTIPLE ECONOMIC CYCLES



SOURCE: *Narrative Economics: How stories go viral & drive major economic events* by Robert J. (Bob) Shiller

Some economic narratives show incredible longevity, rearing their heads in mutated forms across centuries. Consider the story of "machines taking our jobs". Shiller uses Google Ngrams to search for frequency of use of the phrase "labour-saving machine" to demonstrate the coincidence of a spike in its use with the luddite movement in the 1800s in the UK, as weavers fought the loss of their jobs to mechanical looms (see graph).

Less widely-known is the role this same category of narrative played in the Great Depression. Here the phrasing was "technological unemployment". This term rocketed alongside the famous Wall Street crash and ensuing recession. The narrative of robots taking over was, in Shiller's words, "a strong reason for pessimism and reluctance to buy or invest". Today's equivalent of this narrative takes the shape of "artificial intelligence" taking our jobs.

Very well, you may say, but how do we use this practically to better understand markets and advise clients? It's not of much use if narrative economics amounts to incorporating stories into our gut-feel decisions and dissecting recessions post hoc. Shiller is the first to concede this is a novel lens that very few are studying. However, he's adopted an existing science with an uncanny relevance to narratives. It just so happens that all of us had a crash course in this medical specialty with the Covid-19 outbreak. Where epidemiology models the spread of viruses, it can do the same with narratives. That is, narratives follow epidemic models.

From the early days of the coronavirus pandemic, experts monitored the contagion rate. That is the number of people, on average, infected by each person who contracts the virus. In narrative economics, think of that as the number of people each person tells the narrative to. Likewise, what epidemiologists term the recovery rate, we can roughly translate to a forgetting rate – the number of people who hear a story but forget it.

Epidemiological modelling therefore gives us an already advanced science with which to turn the ideas of narrative economics into implementable tools. By way of example, one promising line of study is analysing popular media narratives to generate measures of emotion and, in turn, how investor emotions relate to speculative bubbles.

What does narrative economics mean for money managers? This is a ground-level opportunity. There will be laggards. There will also be those who monitor and embrace the rise and formalisation of this powerful perspective to develop better models, build more valuable products and provide superior advice. ■

Ian Macleod has a background in both business and journalism. He is a member of the GIBS Centre for African Management and Markets.

Photo: Gallo/Getty Images

By Paul Nixon

BEHAVIOURAL FINANCE

Better investment decisions should be everybody's beeswax

Sidestepping the market 'sirens' on a lifelong journey to financial wellbeing.

Journeys are part of the human condition. We possess an almost paradoxical nature of resisting change while simultaneously longing for new experiences. All the preparation in the world, however, cannot take away the inherent uncertainty and risk that exist in these journeys and they often, when recounted, can provide readers with many enthralling tales and opportunities to learn. The tale of Odysseus' journey back to Ithaca is one that has many parallels to the way that clients, advisers, and investment managers make investment decisions.

Like travellers, investors bear a similar disposition and face similar challenges. They sacrifice consumption today in the hope of being rewarded over time for braving sometimes very turbulent market waters. This inherent uncertainty, however, is often enough to either keep us from jumping in – thus forgoing the returns we need by investing over time – or, alternatively, jumping ship mid-journey to what appears to be a better-equipped vessel to get us where we're headed. This behaviour applies to all parts of the advice chain and these behaviours can have a significant cost on the outcome achieved by the client.

The Covid-19 global pandemic and its extreme impact on the financial markets has focused attention on these behaviours of late.

Human beings in general detest uncertainty – it is way more stressful than knowing something bad is going to happen – according to the authors of "Computations of uncertainty mediate acute stress responses in humans", published in *Nature Communications* in 1996. We even have machinery located near our brainstem called the locus coeruleus that is continually trying to predict negative outcomes and prepare us accordingly, Craig Berridge and Barry Waterhouse wrote in an article published in *Brain Research Reviews* in 2003.

Furthermore, research presented by Wharton Business School in 2016 demonstrated how the stress hormone cortisol makes us more likely to use our gut instinct. Our natural stress response (forgoing critical thinking) is therefore setting us up to make investment decisions that are likely to have poor outcomes.

The long-term effect on wealth as a result of these decisions should not be underestimated. After studying the investment behaviour of nearly 18 000 South African investors over a decade (2008 – 2018), it became clear that:

1. The fear that uncertainty elicits is a dominant motivator. Investors were 2.2 times more likely to switch investments (abandon ship) when they perform poorly (between 0% and 5% per year); and

2. On average, this switching activity causes a lower investment return. This "behaviour tax" is about 1% per year on average during turbulent markets because investors are generally in the wrong place at the right time (when markets recover).

Following the battle of Troy, Odysseus set sail for his home of Ithaca, facing many trials on the way. He needed to devise a plan for a particularly treacherous area where sirens lured unwitting sailors to their demise with hypnotic melodies. Odysseus understood his limits and that his knowledge of the uncertainty was necessary, but not sufficient in preventing the ultimate demise of his ship, crew, and himself. He therefore decided to tie himself to the mast of the ship and to place beeswax in his crew members' ears to protect themselves from making an almost inevitably poor decision.

This event is a great metaphor for the challenges facing clients, advisers, and asset managers in times of crisis. How they deal with these challenges is vital for successful client investment outcomes – exactly what everyone should be paid for.

The financial adviser plays the same critical role as Odysseus. They are the planner, strategist, guide, and mentor.

While, as a profession, the six-step financial planning process has set down a crucial framework for providing more consistent advice, the emphasis remains on the quantitative assessment of a client's financial state with little or no regard to how the client got there.

Assessing a client's so-called money scripts or their relationship with money from an early age could flag psychological obstacles to the implementation of their financial plan, as pointed out in a 2012 article by Sonya Britt and Bradley Klontz, published in the *Journal of Financial Planning*. Advisers will need to add psychological dimensions to their skillset in providing effective investment advice.

Asset managers also need to deal with this challenge – they need to provide more reliable vessels to chart and navigate these uncertain waters. This means diverting resources away from the pursuit of elusive alpha and towards providing more predictable outcomes aligned with investors' goals, as explained by Robert McDowall in *Folklore*.

The insights provided by behavioural finance should be used to create a system that provides greater predictability to clients and more confidence to tie their hands behind the mast and place a little beeswax in their ears when the market sirens start calling. ■

Paul Nixon, certified financial planner, is head of technical marketing and behavioural finance at Momentum Investments.

Photo: Gallo/Getty Images

By Grant Locke

DIGITAL ADVICE

What Covid-19 has taught us

The crisis shows that investors don't want to beat an index, but rather meet their savings goals.

Covid-19 came out of nowhere and the world ground to a halt. It stopped people from going to work, visiting friends and family, going on holiday, eating out and shopping for anything other than the essentials.

It halted global trade and interrupted many businesses, and has led to what might become known as the fastest rise in the unemployment rate the world has ever seen. It changed the behaviour of probably around a billion people overnight.

This pandemic almost stopped financial markets. From 20 February to 23 March, many global equity markets – including the UK, US, Europe, Australia, and many others – fell by over 30% as investors panicked and sold everything they could. As it stands, equity markets have recovered some of their losses. Some of us are wondering what is driving the recovery, given that the full effects on the global economy are yet to be understood.

For financial advisers, this begs the question as to how to provide investment advice during something as unprecedented as this. The investment industry has, almost collectively, shouted at all its customers to "stay the course, stay invested".

Everyone was hopeful that John Bogle (the founder of Vanguard and known as the father of index investing) was right when he said: "Stay the course. Regardless of what happens in the markets, stick to your investment programme. Changing your strategy at the wrong time can be the single most devastating mistake as an investor. Just ask any investor who moved a significant portion of their portfolio to cash during the depths of the global financial crisis of 2007-2008, only to miss out on a part or even all of the subsequent bull market."

It wasn't until a meeting a few weeks ago, when the OUTvest actuarial team presented the performance of our investment tracking system during the market crash, that we suddenly realised we were able to prove this advice is true for each client.

The 30% fall in equity markets for almost all clients did not have a major impact on them achieving their objectives on our platform. In fact, it only affected 3% of our clients using our investment tracking system.

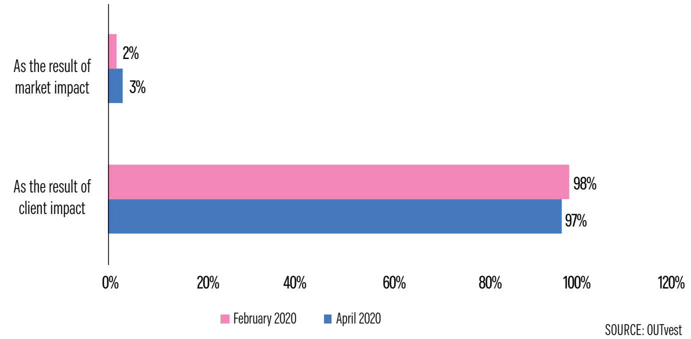
Our investment tracking is a real-time system that can be turned on or off at any time. It recalculates the performance of the client's investment against its forecast outcome when the client logs in or changes their desired investment outcome, desired market value of the investment or amends their contribution and withdrawal timelines.

One of its most important features is its ability to understand why an investment is not on track to achieve the projected forecast, and this was key in helping to understand why a sharp, relatively short-lived market crash did not push our clients off track.

Surprisingly enough the dominant reason for our clients currently being off track to achieving their investment objectives is not related to the market crash in March. The major reason why 97% of our clients who use the system are off track is because of their own actions: early withdrawals, contribution changes, plan changes and the like.

Even more interesting is that the proportion of clients who are now off track between February and April only increased by 3%, from 54% in February to 57% in April, despite the market drops.

REASONS OUR CLIENTS ARE OFF TRACK, TAKING THE MARKET CRASH OVER MARCH 2020 INTO ACCOUNT



SOURCE: OUTvest

The reason is partly because the investment return of every single investment contract is not the same. Every client invests a different amount at different times, and those who are in the early stages of their investment journeys should care the least about market falls.

What we realised is that with advice technology like this, we can assess the impact of market performance individually and provide individualised guidance to help them get back on track. And we can do this instantly. We are genuinely only now beginning to understand the power of these systems.

We also learnt that time-weighted return is a useless method for any performance comparisons for an individual client. It's a comparative designed to compare the returns of fund managers excluding cash flows, but cannot be used to assess whether a client will achieve their investment objectives.

The major reason why **97%** of our clients who use the system are off track is because of their own actions: early withdrawals, contribution changes, plan changes and the like.

Clients experience the money-weighted return of their investment – this is the measurement of the return that gets them to where they want to go.

Clients want to meet savings goals, not beat indexes.

Moving to an outcomes-based investment approach is more than just about changing the investment product. It's about linking the investment product and the client's objectives. The only way to do this is through regulated advice, whether directly to the consumer or through a financial adviser.

Embedding digital advice systems into the process can be life changing for individuals trying to reach financial objectives. The investment plan becomes organic and flexible and links more closely to the events in the life of the client, rather than an annual review meeting.

This technology can also help advisers who are trying to scale their practice, reduce their cost burden and can improve compliance while reducing administrative burdens. It also means that the systems can support the advisers in becoming much more proactive when it comes to the support needed by clients. ■

Grant Locke, CFA, is head of OUTvest.

By Louis van der Merwe

FINANCIAL PLANNING

The financial advice model of the future

How employer-facilitated advice can boost employees' financial wellbeing.

The distribution of financial advice favours clients that have already accumulated assets and are approaching the de-cumulation or retirement phase. Less than 6% of the South African population benefits from receiving this form of financial advice.

The value of advice lies in both the technical elements and relationship elements. Technical value refers to factually correct and accurate plans as well as constructing and implementing various financial products in line with the plan. Relationship value refers to the confidence and trust that the client has in the adviser to assist them in achieving their objectives through ongoing support and coaching.

I want to propose a financial advice model that better suits clients in the accumulation phase of their working life. The highest value of financial advice in South Africa lies in the ability to assist working-age employees to better plan and manage their finances to support not only themselves, but also their financial dependants.

Employer-facilitated advice

I'd like to introduce employer-facilitated advice that supports the technical and relationship elements of financial advice; thus, a marriage of retail and institutional advice.

Financial planning as a benefit offered by employer groups alongside retirement funds, group assurance, and medical aid to reduce financial stress, increases employee productivity, retention and ultimately attracts new talent.

Financial products can be distributed on an employer level with enough flexibility to implement financial plans on an individual basis, supporting a strong focus on cost reduction. Access could be in the form of existing umbrella funds, group assurance, group tax-free investments and contributing to voluntary investments via an employer portal. The implementation on employer level would ease the administration burden on the client and the adviser.

A financial adviser and benefit consultant would work together to create a suite of cost-effective and transparent financial products, assembling a shortlist that an employee can utilise on the employer platform.

The role of the financial adviser

Advisers would be able to focus on the financial planning process within the framework of the employer-provided product structure. This would be an important shift to comprehensive financial planning. By creating a goal-based financial plan, the advisers can demonstrate the financial impact of each decision in terms of the funding level relative to the goal.

Advisers can offer educational training through webinars and newsletters to increase awareness and improve the general level of financial literacy. Group financial planning sessions can be held to help scale the distribution of advice and allow junior advisers to hone their skills.

Financial advice can take place over time in a modular form, to help the employee address the area that requires the highest priority. This will reduce the cost of advice by limiting the amount of time it takes to prepare the financial plan. A key component in the modular, goal-based planning is allowing the employee to create an achievable and realistic goal. The adviser should focus on action steps that would guide the employee closer to their goals.

LEVEL OF CONTROL		
LOW	MEDIUM	HIGH
Returns, start retirement date, end retirement date	Current income, withdrawal during retirement	Fees, contributions, escalation of contributions, future commitment

By combining coaching and counselling skills, the adviser would be able to empower the employee to better manage their finances, shifting the focus to help generate insights in terms of their money and their life.

The employee should understand that they do have control over their financial situation. One of these examples could be retirement planning, where the employee has various elements that can be adjusted to create a better outcome (see table).

Demonstrating the impact of each area in the context of their personal goals often creates a new way of looking at their finances.

Utilising technology

By utilising payroll and data integration technologies, real-time financial plans can be created. The employee can permit the employer to share information with the company-contracted adviser through an employer portal. The adviser will receive information related to their salary, deductions, current retirement savings, financial dependants and insurance information integrated directly with financial planning software.

Photo: Gallo/Getty Images

A virtual consultation can be scheduled with the employee, allowing the employee to supplement the data so that the adviser can amend the financial plan. The adviser can assist the employee by coming up with their solutions, which may include increasing contributions, committing to future contribution increases or supplementing their income through alternative sources.

Sustainable adviser business model

The model would facilitate a shift from investment advice to comprehensive problem-solving and planning, helping employees weigh up complex decisions. The relationship moves from transactional to transformational.

Adviser remuneration can be facilitated through payroll deductions and employer subsidies. The fee can be calculated as a percentage of payroll and agreed upon based on the complexity of the needs of the employees. This allows for a more sustainable and predictable income stream to fund the financial advice team.

Implementation

The technology is readily available but will require a shift from the current focus on financial products to the actions and habits of the employees to move them closer to their financial goals. By empowering employees, we create an environment in which they construct actions within the framework of employer-facilitated advice. ■

Louis van der Merwe, certified financial planner, is the co-founder and a director at WealthUp.