

## RETIREMENT INCOME

# WHERE'S THE ORIGINAL THOUGHT AND CREATIVITY IN TODAY'S FINANCIAL PLANNING?



**Guy Anderson, Director of Retirement Income Distribution at Just, considers the impact of technology in transforming centralised investment propositions and customer experience, while managing risks.**

**It could be argued that, compared to other industries and professions, financial planning and retail wealth management have been consistently late adopters of technology.**

Until recently, few planning firms had a website that was more than just a static advert for their services, but in quick order we have moved on to such an extent that most firms now have online client portals, and some even offer their clients a fully online experience.

The technology at the heart of this transformation has allowed planning and wealth management firms to centralise and systemise their value propositions and customer experience. Clients can be moved seamlessly through risk assessment software, 'know your customer' information gathering, research & recommendation and advice execution. All before ending up in a back-office customer relationship management system to help the firm capture the long term value of the client. This 'long term value' was given an injection of steroids back in 2015 with the introduction of Pension Freedoms; a development that made every wealth management client far more valuable.

It could also be argued that this greater level of centralisation and systemisation positively contributes towards regulated firms evidencing their compliance with numerous FCA suitability requirements such as TCF, PROD and the new Consumer Duty. So, is it all a win/win?

### **Painting by numbers**

Well, back in the early 1950s, a chap called Dan Robbins founded the Palmer Show Card Paint Company and went on to launch a completely new concept...Painting by

Numbers. At the heart of this innovation was the idea that even those with limited [or no] ability or creativity would still have the satisfaction of being able to knock out a Mona Lisa like da Vinci. Even if it only really stood up to scrutiny from a distance.

**This new art genre gave rise to a new adjective; 'paint-by-numbers' with the Collins dictionary stating its meaning as "formulaic; showing no original thought or creativity"<sup>1</sup>**

So, Dan Robbins had effectively taken away the need for someone to possess any understanding of art, or to have an artist's eye, and replaced it with a systemised approach to painting, resulting in a consistent outcome. Nothing wrong with that I hear you say. Well, maybe not when it comes to recreational art, but it might be a different story when we consider the implications for financial planning and wealth management.

### **The end of the Great Moderation?**

As we recognised at the start of this article, the centralisation and systemisation of the advice process and probably more importantly, the management of a client's wealth, has been a fairly recent phenomenon, spurred on by the Retail Distribution Review 10 years ago and by other subsequent events such as Pension Freedoms. The steady growth and low inflation environment during this period, and for a decade or so before, was very supportive of what has happened: a retail asset management system predicated on the ideology of Modern Portfolio Theory and its core tenet of portfolio diversification. This period has often been

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referred to as 'The Great Moderation' but respected asset managers such as BlackRock are now saying it has ended<sup>2</sup>.

So, what could the implications of the ending of The Great Moderation be on this more centralised and systemised approach to managing client money?

The glib answer, I suppose, is the more we have become slaves to the machine, the greater the risk that any failures identified in suitability become systemic rather than isolated. Let us look at one particular area as a potential example of what we mean.

The point in a typical centralised process where the financial planning and wealth management closely overlap is early on. It's where the amount of market risk a client needs to take to meet their goals, in addition to how they feel about taking those risks, and their capacity to take them, are all identified. The software used to carry out this analysis will then recommend a strategic asset allocation, usually from the four main asset classes of equities, fixed income, property and cash.

Core to the strategic asset allocation these risk systems recommend, is a belief that has held true during The Great Moderation which is, the correlation between these four asset classes is sufficiently negative to provide the necessary diversification to optimise the risk/reward trade-off. But the ending of near zero interest rates around the globe, because of a move towards more procyclical monetary policies, has created increasingly positive correlations leading to reduced downside protection and therefore, increased portfolio volatility.

### Anticipating systemic risks

As a result of these changes in the macro-economic landscape, two potentially systemic risks can be anticipated if current processes go unchecked, both driven by this automated asset allocation decision making.

The first is one of potential risk misalignment and miscommunication. Portfolios or funds with significant fixed income holdings have traditionally been categorised and communicated to clients as low or below average risk. Yet as we witnessed in 2022, these investments fared worse than those with higher weightings in equities, contrary to how the risk/reward trade-off is currently explained. If we are leaving The Great Moderation behind, along with the long running views on how to create diversification in portfolios, how should this be addressed in terms of asset allocation and client communication going forward, especially to those in decumulation?

The second potentially systemic risk is more nuanced and probably more controversial, but I think is worthy of putting out there. Think about global interest rates having been at record lows for over a decade and the impact increasing interest rates would have on the capital value of collective fixed income funds being a known/known [in the form of modified duration data].

Was slavishly following automated asset allocation decision making appropriate for certain clients? Especially those moving into decumulation over the last two or three years? Hindsight is indeed a wonderful thing. But some will argue that hindsight was not needed to be able to predict what was likely to happen to fixed income holdings as interest rates increased.

### Rethinking centralised retirement propositions

Here at Just, we have been talking to many businesses involved in providing and facilitating retirement advice during this period of turmoil, about the uncorrelated nature of guaranteed income and how incorporating it into a drawdown portfolio can enhance outcomes and deal with the sorts of challenges I have outlined above. Guaranteed income rates increased significantly in 2022 as collective fixed income capital values dropped. This means clients and their advisers could effectively wipe out those capital losses by switching some fixed income holdings to buy some guaranteed income.

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**With the announcement of the advised retirement income thematic review, it feels like an appropriate time for firms to revisit and review their centralised retirement propositions. And look at the benefits of blending solutions to deliver more thoughtful and creative outcomes for new and existing retirees.**

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To finish, I'd just like to stress that by no means all financial planning and wealth management businesses have allowed themselves to become truly systemised and slaves to the machine, preferring instead to harness technology to help them see each client as an individual, inform client discussions and create greater understanding. But where centralisation and systemisation has led towards a 'planning by numbers' approach, it's not hard to see how the second cross-cutting rule of the Consumer Duty could be used by certain types of organisations who have loads of previous experience in harnessing the benefits of hindsight.

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**If you'd like to hear more about how we can help you with blending solutions to deliver better outcomes for your clients' retirement income portfolios, please get in touch with us, either by phone on [0345 302 2287](tel:03453022287) or via email at [support@wearejust.co.uk](mailto:support@wearejust.co.uk).**

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<sup>1</sup><https://www.collinsdictionary.com/us/dictionary/english/paint-by-numbers>

<sup>2</sup><https://uk.finance.yahoo.com/news/great-moderation-over-new-stock-market-blackrock-150020537.html>

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## FOR MORE INFORMATION

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