

Advice: Cut Your Costs of Wealth Management (Part 1)

Why Small Numbers Have A Big Impact On Your Wealth

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In the first part of our series on how much clients should pay for their wealth management we look at the often underestimated significance of slight changes in costs on the overall performance.

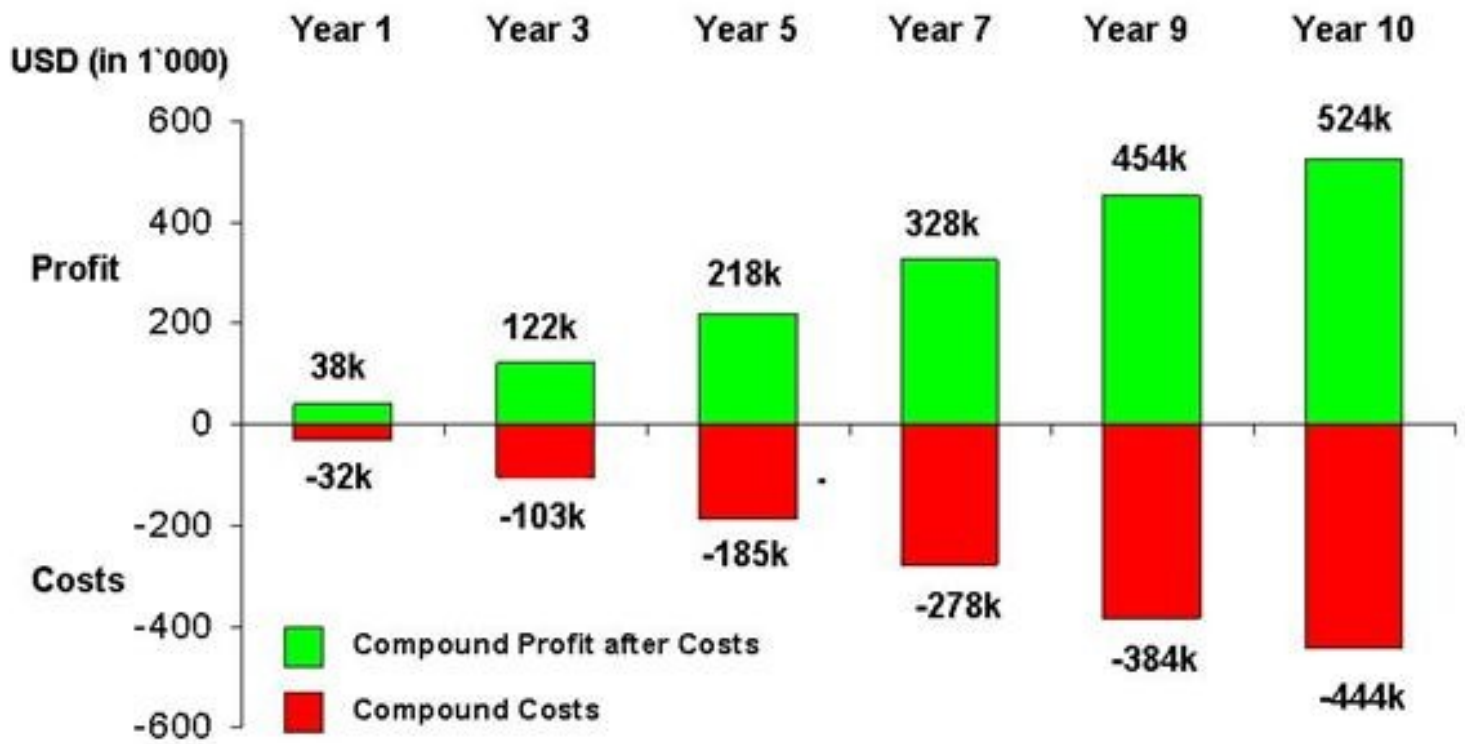
The costs that wealth managers show their existing or potential clients have always one thing in common: They look small. "All-In-Fees" usually range between 0.8% to 1.6% per year, and clients who want to be charged by transaction have to pay fees mostly as part of a thousand per transaction. These are small numbers that seem to be insignificant. But in fact they have a huge impact on your wealth and consequently, your life: Why is this so?

Costs Add Up Enormously Over Time

The success of wealth management can only be determined in the long run. Apparently small costs can add up immensely over time, and via compounded interests will reduce your returns significantly. The absolute costs grow pro-rata with the increase of the assets. The table shows how a "Total Cost of Wealth Management" Rate of 3% p.a. will generate compound costs of about USD 450k after 20 years (Based on an initial investment of USD 1 million with an average return of 7% p.a.).

Costs can add-up enormously over time

Example: Investment amount 1 million USD, 7% performance p.a., 3 % Costs p.a.



Compound Profits vs. Compound Costs (in USD 1'000)

A yearly growth of your assets by 7% will not only grow the total assets significantly, but also the yearly cost of wealth management. 3% p.a. will eat up almost half of the gross profit. While cost figures of 2% to 3% look rather small in absolute terms, they are very high in relation to the average yearly performance of 3% to 7% you are most likely to achieve.

The following table shows how much you lose depending on your total costs p.a. when you invest in USD 1 million with an average performance of 7% p.a.:

Lost Profit after Total Costs of Wealth Management

	Total Profit before Costs	Costs p.a.: 1%	Costs p.a.: 2%	Costs p.a.: 3%	Costs p.a.: 4%
10 years	967k	-148k	-296k	-444k	-591k
15 years	1.759k	-269k	-538k	-807k	-1.076k
20 years	2.870k	-439k	-877k	-1.316k	-1.755k

Table 1: Lost Profit with different Total Costs of Wealth Management

Never forget inflation

It seems obvious, but often wealth managers as well as clients “forget” to take inflation into account. When assessing the performance and determining the investment strategy to achieve specific income per year, you should always work with the real performance (Gross profit minus “Total Costs of Wealth Management” minus inflation).

Inflation usually ranges from 2% in mature economies and up to 10% or more in emerging markets. In the 1970s and 80s, inflation had reached double digits even in developed countries. You should always calculate the performance targets by not only taking the total costs of wealth management account, but also the average inflation you have to expect for the main currency of your portfolio.

As a client it is very important to understand that these seemingly “small numbers” of yearly costs of wealth management and as well inflation will in the long-term have a huge impact on their wealth.

In the next part of our series we [analyse the cost drivers and pricing models of wealth management](#). Only if a client understands the various factors impacting his costs he will be able to reduce them.