The Gamma Factor and the Value of Financial Advice

SUMMARY OF FINDINGS

THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

In August 2016, the Center for Interuniversity Research and Analysis of Organizations (CIRANO) released its latest publication by Claude Montmarquette and Nathalie Viennot-Briot examining the value of financial advice.

A key feature of this study, *The Gamma Factor and the Value of Financial Advice*, is that the authors were able to restrict their analysis to those advised households that had chosen a financial advisor. The survey questioned respondents on the same issues as in 2010, but added an additional question designed to segment out those households where an advisor sought out a client. They found that more than 85% of advised households chose their financial advisor as opposed to having been directly approached by one. This additional data allowed the researchers to address a potential bias of the earlier work and resulting criticism that households with advice may be wealthier because these are the households that advisors target. Despite this change, the authors reaffirm, and in fact strengthen, the results found earlier – that clients with an advisor grow their assets at substantially higher rates than clients without advice.

THE PREVIOUS WORK

The authors' previous study on the value of financial advice found that participants using a financial advisor accumulated substantially more assets (173% more over 15 years) than comparable non-advised participants. This difference is explained by higher savings rates and a greater allocation of non-cash investments – disciplined behaviours acquired through financial advice.

THE CURRENT STUDY

The 2016 study is based on an Ipsos-Reid survey conducted between July and August 2014.

The results on asset accumulation are even more significant than in the earlier study. After adjusting for nearly 50 socio-economic and attitudinal differences, investors with advice were found to accumulate 290% or 3.9 times more assets after 15 years than comparable non-advised investors. By examining results for respondents who participated in both the 2010 and 2014 samples they were also able to report that households that dropped their advisors between 2010 and 2014 gained significantly fewer assets compared to those that continued to be advised.

CONCLUSION

The term 'Gamma' refers to the additional value that investment planning provides by helping clients make better and more informed financial decisions. It is not to be confused with 'Alpha' which refers to the value that portfolio management adds by actively picking stocks and funds that exceed the market's risk-adjusted return. To date, academic literature and public and regulatory debates on matters relating to the value of advice have been largely focused on the ability of advisors to generate Alpha for their clients. The authors are able to demonstrate that the focus on Alpha in these discussions has been misplaced. They show that Gamma factors – the disciplines associated with long tenured financial advice and higher savings rates – are key to explaining the large observed differentials in asset values accumulated by advised over non-advised investors.

The authors' 2016 study and their earlier paper make important contributions to the current Canadian debate with regard to the client-advisor relationship by providing further insights into the potential consequences of limiting investor access to advice.