





THE THEORY AND PRACTICE OF INVESTMENT ADVICE IN FINANCIAL PLANNING

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It is generally accepted in the literature and in practice that risk and return are central to the issue of investment selection. For most people, the process of forming and managing their own portfolios according to the currently held theories of risk and return is a difficult task. Financial planners are a key source of guidance for many individuals, especially when the range of investment products, assets and alternatives are numerous.

Extending this line of thought, it seems reasonable to expect that those who give investment advice are trusted to do so because they understand and know how to apply the parameters of risk and return to portfolio management. In this we also recognise that the financial planner must integrate other considerations that do not fit neatly within the parameters of risk and return, such as lifestyle investment assets, already-owned assets and tax considerations. However, “the theory” still holds and the principles still apply when these factors are held constant.





The implications of “the theory” are also significant in terms of the investment advice that financial planners give clients

Within the wider finance literature, portfolio theory and its implications are well documented. “The theory”, which will be addressed in more detail later, began with Markowitz (1952), who illustrated that the performance of a portfolio depends on how the individual assets in the portfolio behave together, rather than the individual risk of each asset. Tobin (1958) extended the work of Markowitz to show that investors need only vary the amount invested in a portfolio of risky assets compared with the amount invested at the risk-free rate in order to manage their level of risk aversion.

From these theoretical foundations came the concepts of diversification and asset allocation that are now well accepted. Evans and Archer (1968) examined the average standard deviation (risk) for numerous portfolios to determine the effect of diversification. Their results indicated that the major benefits of diversification are achieved with relatively few assets providing substantial risk reduction benefit. Brinson, Singer and Beebower (1991) conclude that 85-95 per cent of overall investment returns are attributable to asset allocation decisions. Applications of Markowitz portfolio optimisation have continued to feature in the literature. Schirripa and Tecotzky (2000) examine an investment method that combines the insurance concept of risk-pooling into the Markowitz procedure and find that investors’ returns are higher than had previously been thought possible, with no increase in risk.

The implications of “the theory” are also significant in terms of the investment advice that financial planners give clients. Financial planners must assess their clients’ risk profile and then help them to make appropriate investment decisions. Hogan (1994) discusses how practitioners can incorporate modern portfolio theory into the management of clients’ portfolios by suggesting specific asset-class investment strategies. Evensky

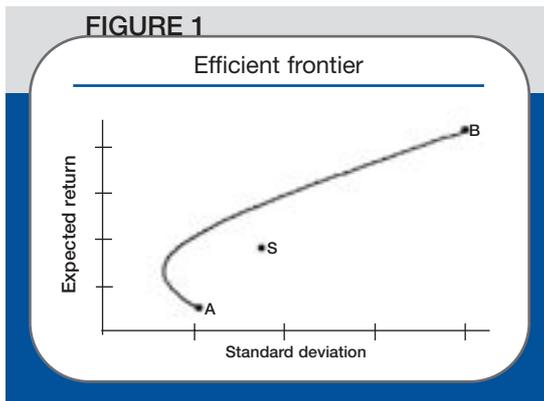
(1997), in reference to Markowitz (1952), examines how financial planners can better communicate with and educate their clients about risk. Evensky’s paper suggests the need to invest in risky assets to reduce the risk of the overall portfolio. More recently, Gibson (1999), in a discussion on asset allocation and financial planning, notes that due to the magnitude of the difference in returns and the correlations among the portfolio components, diversification into an asset class with lower returns does not necessarily result in a lower portfolio return.

In general, however, the financial planning literature has evolved primarily through practitioner-based commentary and casual empiricism, where topics such as insurance, tax, superannuation, ethics and alternative investment products feature widely. Since little or no literature clearly examines how well portfolio theory is understood and applied in financial planning, this research offers a new approach to financial planning research by clarifying the application of portfolio theory in financial planning, whilst attempting to identify and define relevant links between investment theory and the practices of financial planners. These links would be where financial planners “add value” by bringing their experience and education to bear for the sake of their clients.

In addition, this paper tests the validity of the hypothesised links by way of a survey. It is important, therefore, to begin with a brief overview of the theory and its mechanics. This will provide the perspective through which we analyse financial planning practices.

THE THEORY

What exactly is “the theory” and how should it be applied? First we must determine what to invest in (the collection of assets or portfolio to be acquired). Since it is impossible to own everything, it becomes



necessary to decide which assets to include in a portfolio. A portfolio can be described relative to the parameters of risk and return. Harry Markowitz, in the 1950s, developed a method for quantifying risk. Before this, there was much discussion about risk but no quantification and the Markowitz logic still holds today, as far as it goes.

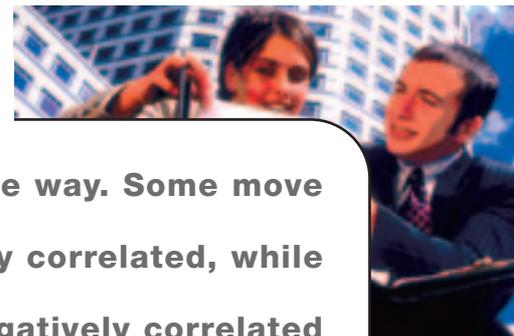
The Markowitz model deals primarily with risky assets and uses standard deviation as the measure for risk. Not all assets behave the same way. Some move together because they are highly correlated, while others are uncorrelated or even negatively correlated. Putting assets together in a portfolio (asset allocation) is not just a matter of finding assets with the highest returns for a given level of risk; we must also consider how the returns of individual assets vary relative to the other assets in the portfolio.

From this standpoint, Markowitz introduced the concept of efficient portfolios and the efficient frontier. An efficient portfolio is one that maximises expected return while minimising risk. Taking into account all the

potential combinations of assets, it is possible to determine which portfolios provide the greatest expected return at each level of risk (efficient portfolios). The efficient frontier, which appears as a solid line, is then created by plotting all efficient portfolios on a single graph, as in Figure 1.

In Figure 1, line A-B is the efficient frontier. Any point along line A-B represents an efficient portfolio, a combination of risky assets that maximises return for a given level of risk. Each point along the efficient frontier represents a different combination or weighting of risky assets. Point S and any other point inside the efficient frontier represent an inefficient portfolio, one that does not maximise return for a given level of risk or minimise risk for a given level of return.

James Tobin, of Yale, was one of several who provided further insight into the developments of Markowitz by introducing the concept of risk-free assets. In the words of Tobin himself, “The fact that one of the available assets in [Markowitz’s] model ... was riskless turned out to have interesting consequences.” What Tobin found and became famous for was that by introducing a risk-free asset into the model, a single portfolio along the efficient frontier could be identified that is superior to all other efficient portfolios. This portfolio has been termed “the market portfolio” and it represents the optimal “risky basket” of assets. Once this portfolio is identified, it stands as the appropriate portfolio of risky assets for all investors, no matter what their level of risk aversion. Importantly, the relative proportions



Not all assets behave the same way. Some move together because they are highly correlated, while others are uncorrelated or even negatively correlated

FIGURE 2

Efficient frontier and capital market line

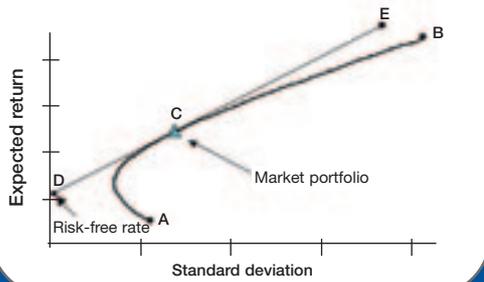


FIGURE 4

Efficient frontier and capital market line

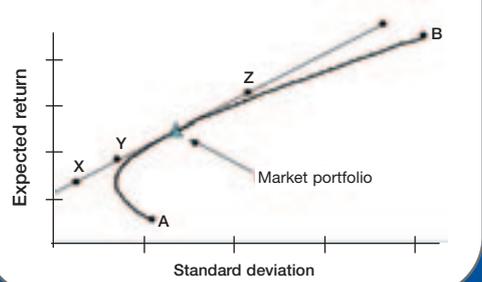
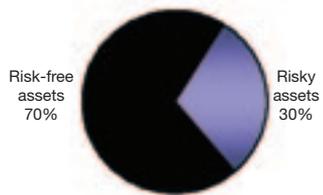
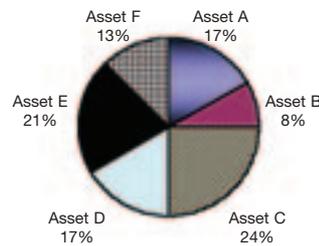


FIGURE 3

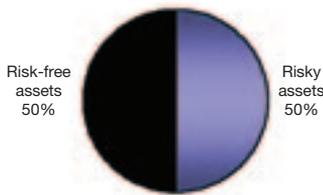
(X) Conservative investor's overall portfolio



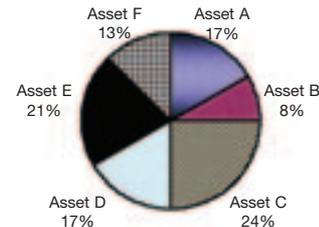
Conservative investor's risky portfolio



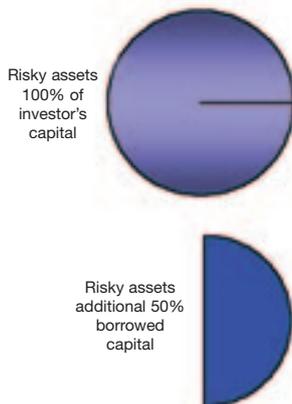
(Y) Neutral investor's overall portfolio



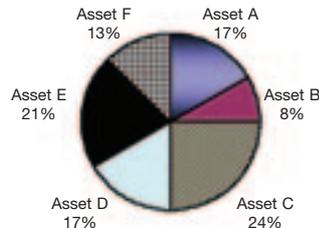
Neutral investor's risky portfolio



(Z) Aggressive investor's overall portfolio



Aggressive investor's risky portfolio



of the assets within this “risky basket” do not change. The market portfolio (the optimal “risky basket” of assets) is found by calculating the tangent point at which a straight line beginning at the risk-free rate touches the efficient frontier (see Figure 2).

In Figure 2, the straight line D-E that is tangent

to the efficient frontier is called the capital market line and the point at which it touches the efficient frontier (point C) is the market portfolio. What investors must determine is where they fit on the capital market line based on their personal preference for risk or, in other words, what amount of capital they will invest at the risk-free

TABLE 1

Investor profile	X Conservative	Y Neutral	Z Aggressive
% Invested in risk-free portion (risk-free asset)	70%	50%	-50%*
% invested in risky portion (risky basket or market portfolio)	30%	50%	150%

*Borrowed money

rate and what amount of capital they will invest in the market portfolio (point C).

This concept developed by Tobin is called the Separation Theorem “because it argues that the Markowitzian process of selecting securities for the most efficient risky portfolio is completely separate from the decision of how to divide up the total portfolio between risky and risk-free assets.”¹ Therefore, customising a portfolio of assets to an individual client’s risk/return preference is not a matter of changing assets or weightings within the “risky basket”. It is a matter of choosing between the risk-free rate and the market portfolio. This also includes the possible decision by an aggressive investor to move further up the capital market line (higher expected return) by borrowing to invest in the portfolio of assets (between point C-E). Any other choice does not optimise the parameters of risk and return. By way of example, **Table 1** and **Figures 3** and **4** depict different investment strategies based upon three profiles of investors: conservative (X), neutral (Y) and aggressive (Z). **Figure 3** demonstrates that while the proportions invested in the risky asset may change, the individual weightings of assets in this category do not.

Conservative investors invest most of their capital in the risk-free asset (70 per cent), which places them down toward the risk-free rate on

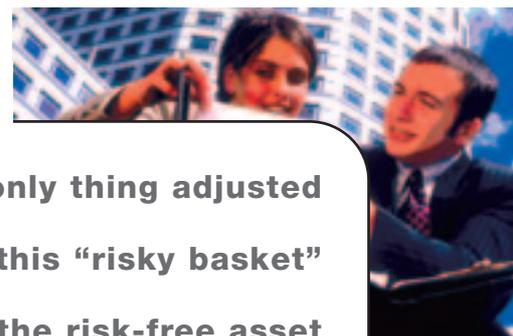
the capital market line (point X). Neutral investors maintain equal proportions invested in risky and risk-free (point Y). Aggressive investors borrow money (realistically not at the risk-free rate) in order to invest in the risky basket of assets, which would place them further up the capital market line above the market portfolio (point Z). The implication for aggressive investors is that they get higher expected returns, but consequently take on a greater amount of risk.

As mentioned previously, the Separation Theorem means that in all cases the relative proportions of investment assets in the “risky basket” (market portfolio) are the same for each investor. As risk preferences change, the only thing adjusted is the amount that is invested in this “risky basket” and the amount invested in the risk-free asset.

WHEN THEORY MEETS PRACTICE

Enter the practising financial planner. Should we expect that financial planners can successfully carry out Markowitz’s process of portfolio formation? In reality, this is no small task. The procedure requires that we calculate the expected returns, variances and co-variances for the investment assets after which we must analyse all conceivable combinations (portfolios) of assets, calculate the expected return for each portfolio to build the efficient

¹Bernstein, 1992, p72.



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While the specific security selection and selection of risky assets may be left to fund managers or other specialists, financial planners must know what the risky basket includes

frontier and then find the market portfolio by introducing a risk-free rate. Whew!

Despite current computing power, which makes the Markowitzian process do-able, it is probably unreasonable to expect that financial planners carry out such in-depth financial modelling and analysis, not least because there are so many potential assets to invest in. In many instances, this procedure is the job of a specialist such as a fund manager or research institution. Some financial planners may even have access to in-house specialists who do the analysis in order to decide which assets should go into the risky portfolio. Still, some may carry out this procedure by themselves. The underlying principle is to establish an optimal portfolio of risky assets (the market portfolio). Following the Separation Theorem, once the market portfolio has been established, this risky portfolio should be the same that is given to all investors.

Again, it is important to recognise that a number of areas exist in which direct application of the theory becomes “fuzzy”: specifically, dealing with lifestyle investment assets, already-owned assets and tax considerations. Dealing with these “fuzzy” portfolio design characteristics is clearly a way in which financial planners add value, but once these considerations have been included and the optimal portfolio has been decided upon, the financial planner must then decide what amount is placed in this risky portion and what amount is placed in the riskless portion. Despite these “fuzzy” areas, therefore, the theory still applies when holding these factors constant. For the purposes of this research, we intentionally avoid asking questions regarding how financial planners deal with these “fuzzy” areas and recognise that these considerations can be given in-depth attention in future research.

Having reviewed the “theory” and, further, recognising that the technical aspects of the theory are not necessarily the focus of a financial planner, we now attempt to clarify how financial planners apply the theory and add value through the investment advice they give to their clients. Within the context of providing investment advice, therefore, we suggest that financial planners add value by satisfying the following three criteria:

1 Determining the risk profile of the client

Central to the role of a financial planner is the task of understanding clients, their lifestyle requirements, preference for risk, investment horizon, tax restrictions and all other considerations in order to build a comprehensive and customised financial plan. All of these considerations must be taken into account when determining a client’s risk profile, which ultimately enables the financial planner to fulfil Criteria 3 (mapping to the capital market line).

2 Determining the risk-free asset and risky basket of assets

While the specific security selection and selection of risky assets may be left to fund managers or other specialists, financial planners must know what the risky basket includes. As well, financial planners must identify the appropriate risk-free asset so they can advise their clients about the suggested capital contribution to each category (risky and risk-free). This is the stage at which financial planners would incorporate the “fuzzy” bits such as lifestyle investment assets, already-owned assets and tax considerations. Duration matching of riskless assets with anticipated future liabilities may also feature here.

3 Mapping clients to the capital market line

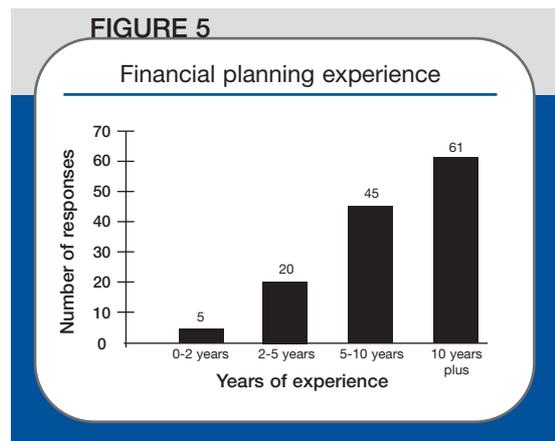
The reason for having undertaken Criteria 1 and 2 is that financial planners must place their clients on the capital market line. In reality, this means helping their clients decide what proportion to invest in the risk-free portion and what proportion to invest in the risky portion. Fulfilling Criteria 1 and 2 makes this possible.

Once an investor is appropriately mapped to the capital market line, all other things being equal, any adjustments based on a change in risk preference of the investor means moving up and down the capital market line. The proportions invested in the risky portion and risk-free portion are altered. But the relative weightings of individual assets in the risky portion would not be altered to ensure providing the client with an optimal portfolio.

SURVEY OF THE PRACTICE

In order to gather information regarding investment advice in financial planning, an e-survey (online questionnaire) was created that asked direct questions regarding the investment advice financial planners give to their clients. We selected 350 financial planners in New Zealand for this survey. Of the 350 potential respondents, we received 144 responses of which 131 were useable. This represents a 40 per cent response rate or a 36 per cent useable response rate. The financial planning experience of our respondents is detailed in Figure 5.

The majority of respondents have been financial planners for at least five years or more (81 per cent), with an overall 47 per cent having



been financial planners for 10 years or more. This would suggest that the subsequent information from this survey comes from those who are more knowledgeable in terms of financial planning practices rather than being relative “novices”. Furthermore, it supports the view that the results from the survey provide an accurate and credible view of the investment advisory component of financial planning in New Zealand.

Questions were asked that addressed the issue of value. We find that 68 per cent of respondents “strongly agreed” with the statement that financial planners add value through the investment advice they give to their clients; another 28 per cent of financial planners also “agreed” with this statement; three per cent “neither agreed or disagreed”; and less than one per cent (one person) “disagreed” with this statement. Further to this, 54 per cent of financial planners provided additional comments to explain their response to this question. In the case of those who “strongly agreed” and “agreed” with the statement that financial planners add



Sixty-eight per cent of respondents “strongly agreed” with the statement that financial planners add value through the investment advice they give to their clients

TABLE 2

Reasons why financial planners feel they add value from those who “strongly agreed” and “agreed”

Response category	Explanation	% of respondents
Financial performance	Financial planners help their clients to save money (reduce fees) or make money (better returns)	7.5%
Superior knowledge	Financial planners are better qualified and more able (compared to their clients) to make decisions concerning financial matters. This is due to their knowledge, skill, experience and access to research	38%
Empowerment	Financial planners provide clients with education and support so that their clients make better decisions (they act more like a coach)	21%
Customisation	Financial planners match financial plans to best suit the characteristics of their clients	15%
Other	Various other reasons (integrity, organisation structure, etc)	18%

value, four common explanations were expressed (these are detailed in Table 2).

Based on the comments of those who “agree” and “strongly agree”, 7.5 per cent of the responses were explained by “financial performance”, 38 per cent by “superior knowledge”, 21 per cent by “empowerment”, 15 per cent by “customisation” and 18 per cent of responses cited various other reasons. As we see, superior knowledge and empowerment (approximately 60 per cent of comments) are the main reasons why financial planners say they add value through their investment advice to clients.

These results suggest that financial planners themselves also support our earlier assertion that those who give investment advice are trusted to do so because they understand and

know how to apply the theory. In further support of this, 98 per cent of the respondents have taken courses in finance or investment theory and a large proportion (59 per cent) also believe that it is important for financial planners to understand the theory. Additionally, 95 per cent of respondents clearly show that they carry out Criteria 1 of our three recommended steps to applying investment theory by establishing their clients’ risk profiles. They do this by taking into account characteristics such as age, income and financial goals (98.5 per cent) and, further, by taking into account personal preferences for risk (97 per cent). With regard to the investment advice that financial planners give to their clients, 80 per cent give equal consideration to their client’s lifestyle requirements (wants and needs) and preference for risk, 13 per cent give more consideration to lifestyle requirements, and seven per cent give more consideration to their preference for risk. The implication of these results is that financial planners confirm our first criteria of adding value by determining their clients’ risk profiles.

We also find evidence to suggest that financial planners may add value by satisfying our second criteria along the line of portfolio formation. Figure 6 represents our findings of the extent to which financial planners participate in

FIGURE 6

Client’s portfolio formation

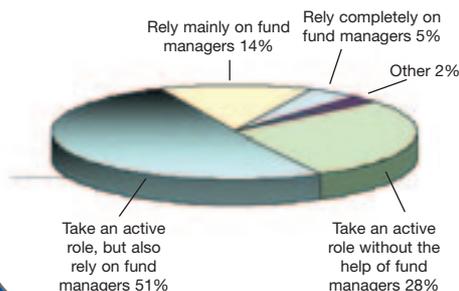
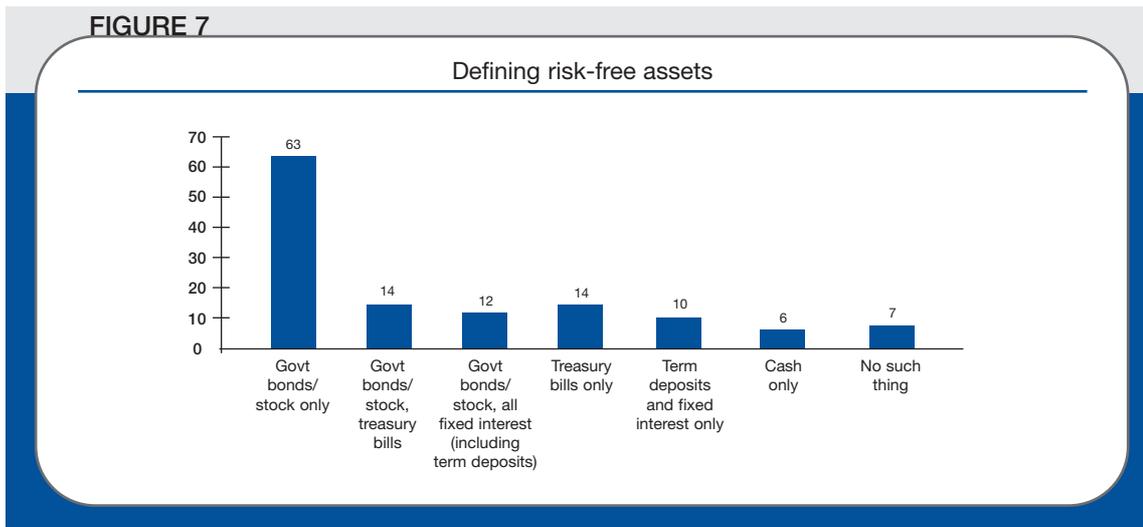


FIGURE 7



structuring their clients' investment portfolios.

Here we find that 28 per cent of respondents take an active role in structuring clients' investment portfolios and 51 per cent take an active role, but also rely on specialists such as fund managers. Therefore, nearly 80 per cent of the respondents are involved in the portfolio formation process for clients. Furthermore, since 98 per cent of the respondents say they utilise, at some level, research supplied by specialists, we may also assume that the process of portfolio creation is based upon credible information. So far so good, in that we find clear support that financial planners confirm Criteria 1 for added value and possibly Criteria 2 also.

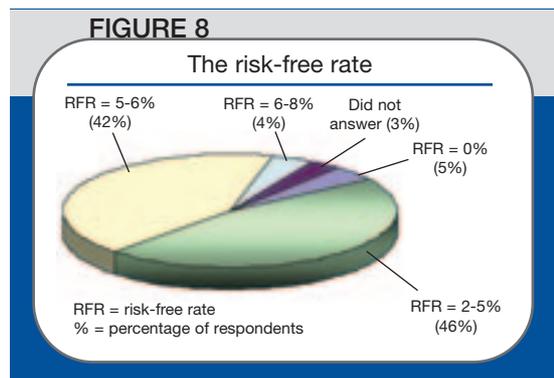
Returning to the currently held theories of risk and return, we posed a number of key questions that help to further clarify the value added by financial planners. We asked the respondents to detail what they consider to be a risk-free asset or investment. **Figure 7** reports our findings.

In terms of risk-free assets, 63 respondents (48 per cent) consider government bonds to be the only risk-free asset or investment, 14 (11 per cent) include treasury bills (90-day) as well as government bonds, while 12 (nine per cent) include term deposits and other fixed-interest securities along with government bonds. Additionally, 14 respondents (11 per cent) consider short-term treasury bills as the only risk-free asset, 10 respondents (eight per cent) consider term deposits and fixed interest to be

the only risk-free asset, while six respondents (five per cent) say cash is the only risk-free asset and seven respondents (approximately five per cent) suggest that there is no such thing as a risk-free asset or investment. We then go further in order to determine what financial planners consider the risk-free rate to be (see **Figure 8**).

It is found that 46 per cent consider the risk-free rate of return to be two-five per cent a year, 42 per cent consider it to be five-six per cent a year, five per cent consider it to be zero per cent and the remainder (seven per cent) consider it to be greater than six per cent, or else they did not answer.

Upon further analysis, we find that 74 per cent of the respondents say the risk-free rate has relevance to the investment advice they give to clients. Moreover, 98 per cent say investors need to consider the risk-free rate of return when they invest in a portfolio of assets. However, the reasons given as to why, although





Financial planners generally consider most assets other than government bonds, treasury bills and (high-grade) fixed interest to be risky

logically sound, suggest that financial planners are using the risk-free rate to aid in security selection (by benchmarking performance) instead of it also being used as a tool to map clients to the capital market line. Specifically, 77 per cent of financial planners who provided additional comments say they use the risk-free rate as a benchmark for risk and return. Other comments were: the risk-free rate is an important consideration when investing funds over short time horizons (five per cent); and that there is no such thing as a risk-free rate (six per cent). Interestingly, only one of the respondents mentions that the risk-free rate has relevance for reasons that are consistent with “the theory”. Even then, this respondent was actually stating that the risk-free rate was never used or applied as “the theory” would suggest. The implication of these findings is that financial planners may not be using the risk-free rate appropriately in order to satisfy Criteria 3 for added value.

It was also shown that financial planners generally consider most assets other than government bonds, treasury bills and (high-grade) fixed interest to be risky. They identified the following as risky assets or investments: shares, property, derivatives, low-

grade bonds and investment schemes. When it comes to evaluating the risk of these investments, financial planners use a number of measures, which are illustrated in Figure 9.

We find that 113 (86 per cent) financial planners use variation or standard deviation of returns as a key measure of risk, with 31 per cent of all financial planners relying solely upon this measure alone to determine risk. A financial planner’s intuition (26 respondents, 20 per cent) and the past performance of an investment (49 respondents, 37 per cent) are also important methods for measuring risk, although no financial planner relied solely on either of these methods. We find that 34 (26 per cent) financial planners also use beta as a measure of risk, 23 (18 per cent) rely on fund managers or specialists when measuring risk, with only three per cent relying entirely upon fund managers or specialists for risk measurement.

The majority of financial planners (66 per cent) use a combination of methods to measure risk. The most common are: past performance and variation or standard deviation of returns (15 per cent) and variation or standard deviation of returns and the beta of an asset (11 per cent). These findings imply that the majority of financial planners are using risk measures that are consistent with those espoused in “the theory”. Therefore, if financial planners are to make appropriate use of these measures of risk (variation and standard deviation of returns), then they must follow “the theory” in terms of the parameters of risk, return and portfolio formation.

We now seek to establish the ultimate link between theory and practice by investigating our third criteria for added value (mapping to the CML). In doing so, a clear contrast between theory and practice emerges. A scenario was

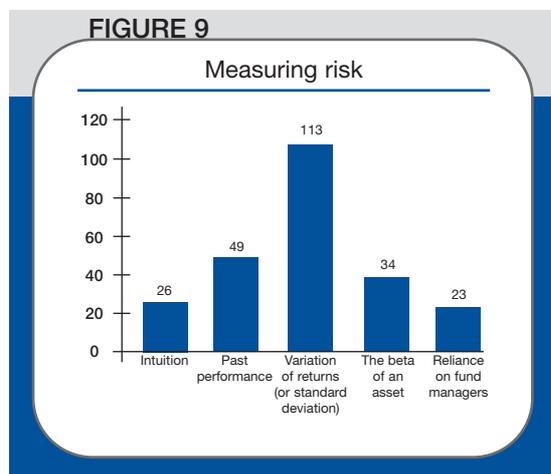


TABLE 3

Without considering any lifestyle requirements, if an investor holds an efficient portfolio of assets, but suddenly changes his or her preference for risk, I believe that this investor should:

Alternative responses	% of respondents
Restructure the portfolio to include assets that better match the investor's risk preference	41%
Change the weightings of the assets in the current portfolio*	52%*
Adjust between investing at the risk-free rate and borrowing to invest in the portfolio*	2%*
Change nothing	2%
Did not answer	3%

*Potentially consistent with investment theory

presented in which we asked financial planners to consider only investors' preferences for risk without other lifestyle considerations such as wants, needs and goals. We asked what recommendation financial planners would give to clients who hold efficient portfolios of assets, but who then change their preference for risk. The results from the various recommendations are presented in **Table 3**.

We find that 41 per cent of financial planners answer that they should restructure the portfolio to include assets that better match the investors' risk preferences, 52 per cent recommend changing the weightings of the assets within the portfolio, two per cent recommend adjusting between investing at the risk-free rate and borrowing to invest in the portfolio of assets, and the remaining five per cent recommend changing nothing or else did not answer. The theory would suggest that only 54 per cent may be doing it right: those who change the weightings of assets and those who adjust between investing at the risk-free rate and borrowing to invest. To add new assets to the portfolio and or drop other assets (41 per cent) is a clear violation of the theory.

But even this does not present an entirely accurate view because if some of those who appear to get it right in fact change the relative proportions of assets within the "risky basket" or market portfolio, then an even greater number are not practising "the theory" properly. Changing the relative weightings of

the assets within the risky portion, at best, only moves the client around the efficient frontier. At worst, the portfolio is no longer efficient and fits inside the efficient frontier. **Figure 10** illustrates this relationship.

By changing the relative weightings of the assets in the risky basket, the investor's portfolio is no longer optimal (the market portfolio). Points L, M, N and O represent portfolios that are efficient, but not optimal. Points P and Q represent portfolios that are neither efficient nor optimal. All these portfolios result from changing the relative weightings of individual assets in the risky portion.

To gain a wider perspective on these results, we recall that nearly 80 per cent of financial planners are involved in the portfolio formation process for their clients. We illustrate the relationship between those financial planners who take an active role in

FIGURE 10

Efficient frontier and capital market line

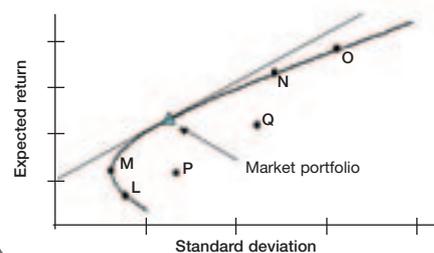
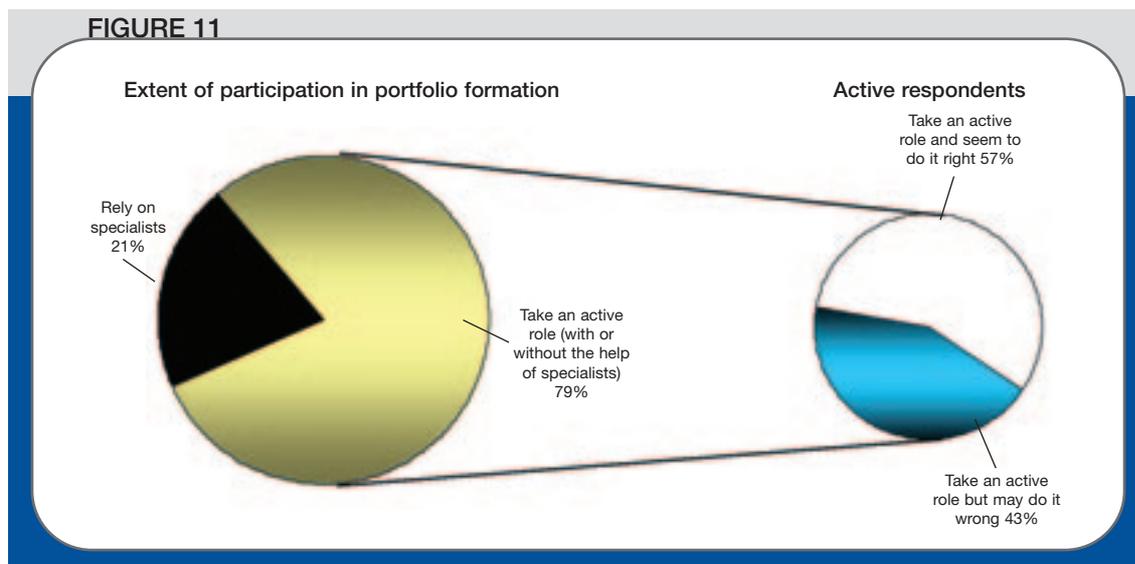


FIGURE 11



portfolio formation and whether they get it right based on the responses from Table 3 (see Figure 11).

Of those who take an active role, 57 per cent seem to be consistent with theory. However, we cannot determine if they are moving their clients up and down the capital market line or changing the proportions of assets within the risky basket (market portfolio). Even if we assume that a large number of those who seem to follow theory

actually do so, a significant proportion of financial planners who are active in portfolio formation (43 per cent) do it in a manner contrary to “the theory”. Therefore, we have mixed results as to whether or not the majority of financial planners satisfy Criteria 3 for added value, mapping clients to the capital market line.

CONCLUSION

In general, according to our survey results, New Zealand financial planners seem to:

- Be experienced.
- Accept the need to understand and follow “the theory”.
- Be actively involved in the formation of clients’ portfolios.
- Understand the difference between a “risky” and “risk-free” investment.
- Use the risk-free rate for benchmarking risky investments.
- Use standard deviation to measure risk, in agreement with theory.
- Add value by determining the risk profile of the client.

Adjusting for lifestyle, already-owned assets and tax considerations will affect ultimate client-specific portfolio recommendations. Beyond these issues, financial planners are responsible for making adjustments to clients’ risk/return profiles in terms of their investment portfolios’ overall asset allocation. The theory



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suggests a clear strategy for undertaking this adjustment. Specifically, altering the proportion of the total portfolio invested in the “risk-free” category as opposed to the “risky” category is the only approach that provides investors with an optimal risk/return trade-off. In practice, after the financial planner chooses which assets to consider for investment potential, an analysis based on investment theory should result in that particular investment advisor recommending one, and only one, optimal combination of “risky” assets to all clients, regardless of a particular client’s appetite for risk.

We find, however, that substantial numbers of financial planners alter the mix of assets in the “risky” category instead. Using the words of the theory, as clients change their risk/return preferences, changing the mix of “risky” assets is similar to moving clients along the efficient frontier and not along the CML. (This assumes that the change in mix is also efficient.) But movements along the efficient frontier will result in sub-optimal performance. In making this movement along the efficient frontier, financial planners are in effect acknowledging one of two things:

- 1 They don’t know what should be in their optimal mix and so they offer a range of different “optimal” portfolios to various clients. In this case, financial planners should again examine the fundamental portfolio building blocks of the theory which suggest that this is inappropriate financial advice.
- 2 They do not understand how to map clients to the CML. In other words, it is possible that financial planners simply do not understand the theory.

Other issues in practice are also important to remember. Some clients’ portfolios are too small for them to efficiently include all assets in the “optimal” mix. A client with a \$50,000 portfolio may not be able to efficiently invest in 20 different assets in the same way as a client with a \$5 million portfolio. Yet even this distinction may also fade as increasingly inexpensive portfolio options become available to accommodate even the smallest investors.

Financial planners enhance the value they add to their clients if they focus on obtaining an opinion on the optimal (i.e. the best risk/return combination on the efficient frontier) portfolio for their clients. By altering the mix and weighting of assets in the risky category when adjusting for changing client risk, many financial planners in New Zealand are not providing theoretically sound investment advice.

The experience of Bernstein offers an appropriate and concluding insight: “Rejecting the gospel of the tailor-made approach to portfolio selection, we were motivated by the simple thought that every client was entitled to benefit from our best ideas. We could vary the character of the portfolio by buying more or less of this stock or that, or by limiting or expanding a client’s exposure to stocks in general, but we could find no good reason why each client’s list of stocks had to be unique.”²

²Bernstein (1992), p 62.

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