Assignment 1

1

To prepare a Statement of Advice (SoA) is to provide personal advice, for it concerns the couple's personal circumstances — who are retail clients without experienced investor status. My obligation would be to follow the statutory fiduciary law of financial planners, a legal duty introduced by the Future of Financial Advice Act. The summary is to act in the best interest of the client, where financial advice cannot benefit the planner without also benefiting the client.

To meet the fiduciary duty, I would need to fulfill the two acts of "Know your client" (KYC) and "Know your product" (KYP). KYC refers to understanding the client's circumstances, risks, and objectives, areas I'm obligated to perform a detailed analysis of and record afterward. KYP refers to my need to understand the fundamentals of financial products, with knowledge of their abilities and limitations in said instruments. KYC and KYP forms the suitability rule that acts as prerequisites for me to legally provide quality personal advice in a SoA, along with the requirement to act efficiently, honestly, and fairly in general.

Regarding the SoA, I must include sections required by the ASIC. Most important is the client's information containing their financial information: assets, existing and projected cash flows, risk profile, expectations and objectives; and personal information: name, address and details, preferences, and family circumstances. I'm required to obtain and sign this recorded information off and use it as a basis for any given financial advice. Moreover, I'm obligated to state any conflicts of interest in financial products and warn if my recommendations are based on incomplete data. I'm also required to list any fees and operate any implementation only after informing the client and getting their written consent to do so.

2

To fulfill the regulatory requirements of the SoA, I additionally require a mixture of personal and financial information from the couple.

To understand the couple's personal circumstances and wishes, I'd seek a mix of basic information, retirement planning objectives, projected lifespan, and their investment and lifestyle preferences. First would be the couple's names, addresses, and contact details. Then would be their retirement objectives, used as a basis for my wealth investment judgments. This may include a simple RIS generation matching their current consumption, or optionally the inclusion of planned trips and major expenditures. I'd also query the couple's intention of their super-fund between a lump sum or a regular pension. In either case, I'd seek the couple's preferred investment horizon and estimated longevity, to best gauge the time aspect of their retirement expenditures. These questions regarding their investment and personal objectives lend me information on how to act in their best interest.

To understand the couple's financial circumstances to the level required by regulations, I'd seek a mix of their current liabilities and debt, additional personal investments, projected after-retirement work-related non-investment income, and risk profile. While I have a detailed description of their current assets, I require their current and expected debt undertakings to construct a fuller picture of their wealth situation for risk assessment and portfolio construction. The query on the existence and magnitude of personal investments achieves a similar goal. It's also for a better judgment of the available retirement consumption that prompts me to query their projected non-investment income from work or royalties. Lastly, I'd ask for all past equity investments and an explanation for their historical asset allocation strategy, for they form the basis of the client's risk profile required for the SoA.

3

I view the couple's current asset allocation to be not optimal under their retirement intent and risk aversion. Their current portfolio with its high proportion of equity may be dangerous for retirement due to short-term volatility. Moreover, their equity portfolio can be improved through diversification and index funds with minimal effort.

My calculations show an approximate 46% cash and 54% equity allocation under market prices, with a modest expected return of 5%[1]. Along with the relatively conservative targeted ratio of 50-50 in their past asset allocations, I view the couple's risk aversion to be low. This is further supported by their industry diversified equities assets, and MP1 — the portfolio's systematically riskiest security[2] — having the smallest weighting of 3.1%. The short-term cash deposit also hints towards risk aversion due to its low reinvestment and interest rate risk. For a more formal assessment of their risk profile, I'd conduct a risk assessment questionnaire and use their historical financial behavior by inquiring about the couple's past equity transactions and debt levels.

On the macro level, the couple's asset allocation can be improved through a more conservative allocation. Due to their low perceived risk tolerance and retirement age ranges, I propose a reduction in the equity allocation towards a more defensive level of 25%. This reduces the impacts of market volatility on the couple's wealth, lowering the likelihood for an upcoming recession to wipe out their RIS generating assets. Similarly, I'd also retain their passive SAA strategy. For the stocks are fully franked, I see no tax trade-offs between stocks and cash investments. On the micro side, switching to an index ETF can optimize the diversification from a mere 5 stocks. This helps to both reducing unsystematic risk and improving cost efficiency by lowering brokerage fees in the future from asset class re-balances.

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[1] See Appendix B

[2] See Appendix A, for its high beta of 1.03

Appendix

A Equity Portfolio

Equity portfolio, beta is 5y statistic from Yahoo Finance

Ticker	Industry	Amount	Price	Stake	Weight	Beta
ANZ	Banking	3000	$24.9	$74700	0.196445829	0.83
BHP	Materials	3200	$43.15	$138080	0.363122358	0.83
CSL	Healthcare	400	$270.85	$108340	0.284912198	0.2
WOW	Consumers Good	1250	$37.75	$47187.5	0.124093542	0.23
MP1	Technology	1000	$11.95	$11950	0.031426073	1.03
Total			$380257.5		0.58233	

Expected return on equity using CAPM, market expected return taken as 8%, risk-free return taken from the couple's cash investment

$$E(r) = 0.0375 + 0.58233(0.08 - 0.0375) = 0.062249$$

B Total Portfolio

Total portfolio

Types	Amount	Weights	Expected Returns
Cash	$325000	0.460824592	0.0375
Equity	$380257.5	0.539175408	0.062249
Total	$705257.5		0.05084