WEALTH MANAGEMENT UNIT 1

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UNIT 1

- Introduction to wealth management
- Personal financial statements analysis – sums on cash management
- Economic environment analysis

MEANING

- High-level professional service

Wealth management deals with helping an individual to build wealth, preserve it and subsequently transfer it to the next generation in a tax-efficient manner.

DEFINITION

According to Investment Management Consultant Association (IMCA),
"a distinct field of practice through which qualified professionals help high net worth client achieve their goals and objectives related to accumulation, protection and distribution of wealth by applying a set of specialized knowledge and skill."

FEATURES

- Client segment – HNIs
- The client is followed throughout life
- Wealth manager could be part of wealth management firm, or solo practitioner
- Management fees vary widely
- Inputs from financial experts and attorneys, accountants, insurance agents.
- Holistic approach instead of advice from several professionals

FEATURES

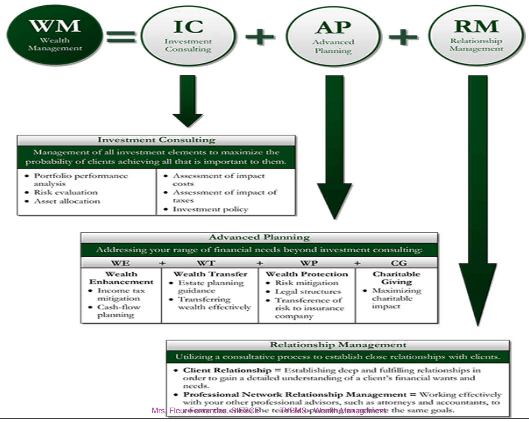
- Manages cash balances as well as income
- Prepare original plan; update goals, review and rebalance; check for additional services needed
- Range of products offered
- Consultative process

COMPONENTS OF WEALTH MANAGEMENT

- Fiduciary services
- Cash flow management
- Investment planning
- Legal advice
- Trust and estate planning
- Tax planning
- Accounting and reporting
- Insurance,
- Debt management and mortgages
- Leasing
- Stock broking,
- Retirement planning,
- Banking,
- Charitable giving,
- Financial structuring, gearing

SCOPE OF WEALTH MANAGEMENT

- Wealth accumulation and development
  - Asset allocation
  - Rigorous security selection
- Wealth protection
  - Current and Future Income Planning
  - Retirement Planning
- Tax minimization strategy
- Estate Investment, Trust and Insurance Planning



WEALTH MANAGEMENT =

INVESTMENT CONSULTING
+ ADVANCED PLANNING
+ RELATIONSHIP MANAGEMENT

Advanced Planning includes Wealth Enhancement, Wealth Transfer, Wealth Protection and Charitable giving

RELATIONSHIP MANAGEMENT

Relationship management is a key activity in wealth management. It has three dimensions:-

- Fully understanding and meeting client's critical needs
- Assembling and overseeing a network of financial experts
- Working with client's advisors, like lawyers and accountants.

DISTINGUISH BETWEEN

INVESTMENT MANAGEMENT	WEALTH MANAGEMENT
Investment management is a part of wealth management.	It is a broader area than investment management.
It caters only to the financial investment aspect.	It address the individual's and his family's needs, goals and objectives.
Only financial securities are managed.	Along with financial securities, Accounting /tax aspects, Retirement planning, Legal/estate planning, philanthropy are managed.
It deals with preserving and growing money.	It deals with preserving, growing, bequeathing, donating money.
This service can be availed by any investor.	Only HNIs and Ultra HNIs are normally provided this service, though less wealthy people can also request for the service.
The investment manager normally functions on his own.	The wealth manager seeks assistance from other experts like lawyers, accountants, etc.

INTEGRATED WEALTH MANAGEMENT TABLE

- Asset management – portfolio management , equity , derivatives, etc
- Structured investment – hedge funds, private equity, etc.
- Financial planning – tax strategy ,estate planning , retirement planning,pension funds etc.
- All types of bank services
- Other services – research , legal counseling etc

PROCESS OF WEALTH MANAGEMENT

- Data gathering for current situation – goal, relationship, assets, advisors
- Define the terms of engagement (Signing of MoU)
- Goal setting
- Identification of needs
- Analysis of opportunities and challenges (SWOT)
- Report preparation
- Implementation
- Review and revision

NEED FOR WEALTH MANAGEMENT

- Growth of HNWI
- Time constraints
- Expertise
- Complexity in financial products
- Globalisation
- Fee based services vs. commission model
- Goal attainment
- Wealth transfer
- Key to retirement
- Lifestyle maintenance

WHAT CUSTOMER EXPECTS

- Customization
- Trusted wealth manager
- Research and product knowledge
- Transparent charges
- Access to information and portfolio
- Accounting and taxation aspect
- Regulation and guidelines
- Ease of execution

TYPES OF HNI CLIENTS

- Entrepreneurs
- Inheritors
- Professionals

TYPES OF CLIENTS

- Relationship Clients
- Fear-based Clients
- Curious Clients
- Greedy Clients

CHALLENGES TO WEALTH MANAGEMENT IN INDIA

- Regulatory environment
- Entry blocks
- Finance literacy
- Sector reach
- Products and services offered
- Consistent service
- Client risk tolerance
- Attracting and retaining advisors and clients
- Uncertain markets and prices
- Shortage of talented professionals
- IT technology
- Lack of trust

WEALTH MANAGEMENT FIRMS IN INDIA

- IIFL Wealth Management
- AVENDUS Wealth Management
- Centrum
- Kotak Wealth Management
- Edelweiss
- SMC Global
- Karvy Wealth
- ICICI Asset Management Company
- Reliance Asset Management Company
- Anand Rathi
- Sanctum Wealth Management

CODE OF ETHICS FOR WEALTH MANAGER BY AIWA

Association of International Wealth Managers is an non profit organisation which encourages, promotes and strength global education for private banking industry and to set recognised standards for qualifications and service ethics of private banking professional.

Rule 1

- Principles of professional ethics
- Independence
- Integrity
- Professional and diligence
- Loyalty and priorities for clients interest

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Rule 2
- Compliance with applicable rules

Rule 3
- Duty of information

Rule 4
- Conflict of interest

Rule 5
- Personal investment transaction of members

Rule 6
- Duty to inform the employer

Rule 7
- Sanctions

FPSB CODE OF ETHICS

Financial Planning Standards Board of India is a public private enterprise and a professional standards setting body that closely works with all the stakeholders.

- Client first
- Integrity
- Objectivity
- Fairness
- Professional
- Competence
- Confidentiality
- Diligence

CHAPTER 2
PERSONAL FINANCIAL STATEMENT ANALYSIS

PERSONAL FINANCIAL STATEMENTS ANALYSIS

Definition - It's a document or spreadsheet outlining an individual's financial position in terms of assets and liabilities at any given point in time.

Example,
Annual expenses of Mr. Rajiv – Rs.2,00,000
Net worth – Rs.8,00,000
If he has no income, his net worth will become zero in just 4 years.

PERSONAL FINANCIAL PLANNING PROCESS

- Assessment
- Goal setting
- Plan creation
- Execution
- Monitoring and reassessment

FINANCIAL LITERACY

- It refers to peoples' ability to process economic information and make informed decisions about financial planning , wealth accumulation, pensions, and debt. It also involves intimate knowledge of financial concepts like compound interest, financial planning, mechanics of a credit card, savings methods, consumer rights, time value of money, etc.

FINANCIAL LITERACY

- The OECD INFE has defined financial literacy as follows:

'A combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.'

- Financial stability traid includes

- Financial literacy
- Financial inclusions
- Consumers protection

FINANCIAL EDUCATION INITIATIVE BODIES

- RBI
- SEBI
- IRDA – Pan India
- PFRDA
- Various other market players
- Others – stock exchanges, broking houses, mutual funds, insurance companies

FINANCIAL GOALS AND PLANNING

- Specific
- Measurable
- Achievable
- Realistic
- Time bound

S M A R T

IMPORTANT ASPECT OF FINANCIAL GOAL

- Goal value
- Time period
- Funding the goal

BASIC FINANCIAL GOALS

- Get out of debt completely
- Plan for early retirement
- Well stocked emergency fund
- Multiple income streams
- Have enough – But not too much – Insurance to cover contingencies
- Be able to live on less than you earn
- Financial planning

ASPECTS OF GOAL BASED WEALTH MANAGEMENT

- Avoid under savings
- Plan ahead
- Data driven target
- Tangible outcome
- Guilt free spending
- Automated plan
- Optimal return

FINANCIAL PLANNING PROCESS

- Definition
- Process
- Choose a professional financial advisor
- Identify your goals and objectives
- Analyse your financial status
- Implement your plan
- Periodically review your plan

IMPORTANCE OF FINANCIAL PLANNING

- Income
- Cash flow
- Capital
- Family security
- Investment
- Standard of living
- Financial literacy
- Assets
- Saving

BUCKETING APPROACH

- Essential needs
- Lifestyle wants
- Legacy aspirations

CASH FLOW ANALYSIS

- Meaning
- Importance

The Plan consists of

- Identifying income and expenditure
- Category of income
- Time period
- Amount required
- Build financial plan

CASH FLOW AND BUDGETING

- Income
- Expenses
- Discretionary expenses
- Want and needs
- Realistic expectations
- Family on board
- Budget form

COMPREHENSIVE FINANCIAL PLAN FORMAT

- Cover sheet
- Forwarding letter
- Table of content
- Personal data
- Executive summary
- Clients goal and objective
- Issue and problems
- Assumption

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- Risk profile
- Asset allocation
- Investment
- Recommendations and projections
- Risk management
- New plans and costs
- Tax
- Estate and will
- Financial statement
- Authority to process

INVESTORS LIFE CYCLE

- Accumulation
- Consolidation
- Spending
- Giving

LIFE CYCLE MANAGEMENT

- Wealth Building(16-20)
- Wealth Accumulation(21-35)
- Diversifying (36-45)
- Retirement Planning (46-65)
- Living (Beyond 66)
- Transferring

The LCM should be SMART.

ECONOMIC ENVIRONMENT

- It consists of external factors in a business environment that influence a business.
- Macro environment consists of the entire economy.

Interest rates
Tax
Inflation

- Micro environment consists of internal factors of the business

Market size
Competition
Suppliers

MACRO ECONOMIC CONCEPTS

- **GDP - Gross domestic product** is the final value of all goods and services produced by a country in a given time period.

- **Index of Industrial production** measures changes in industrial activity with reference to a base year.
- 22 industry classifications
- Indsustrial sector - Mining , manufacturing , electricity and use based sector – consumer goods, basic goods etc.

INFLATION

- It is the rate at which the general level of prices for goods and services is rising form one period to another.
- It reduces purchasing power.
- Headline inflation refers to change in the value of all goods in a particular basket.
- Core inflation excludes food and fuel items since they are more volatile.
- Wholesale price index is computed on monthly basis using the wholesale prices of a basket.
- Consumer price index is a retail index computed on monthly basis.

INTEREST RATES

- It is the rate which is charged or paid for the use of money.
- It changes with changes in inflation and government policies.

IMPORTANCE OF INTEREST RATE

- Decides borrowing cost
- Impacts government deficit
- Impacts capital flow

TYPES OF INTEREST RATES

- Floating/ variable
- Fixed rate
- Capped rate
- Split rate

REASONS FOR CHANGES IN INTEREST RATE

- Political movements
- Deferred consumption
- Inflation
- Alternative investments
- Risks of investment
- Liquidity preferences
- Taxes
- Economy

INTEREST RATE BASICS

- Bank discount rate – Rate charged by central bank
- Funds rate – Interbank rate for call money mostly
- Prime rate – Banks lending rate to its most credit worthy customers.
- Treasury bills/Notes/Bonds

YIELD

- Yield refers to annual return on investment
- It is based on purchase price of the bond and interest rate.
- Bond yields are of two types :
- Current yield – Annual return earned on the price paid for a bond.
- C Y = Bonds annual coupon interest payment amt. / Purchase price
- Yield to maturity – Total return on investors receives by holding the bond till maturity.
- It includes appreciation or depreciation in the price of bonds.

YIELD CURVE

- Yield curve is a line that plots interest rates at a set point in time of bonds having equal credit quality but differing maturity dates.
- It is used as a benchmark for debt rate in the market such as mortgage rates or bank lending rates.
- It is also used to predict changes in economic output and growth.

TYPES OF YIELD CURVES

Normal yield curve
- Upwards sloping, all else being equal, a bond with long-term maturity pays a higher yield than that of shorter maturity.
- Longer the duration higher is the risk.
- So to compensate for extra risk with lending money for long-term lenders demand high rate of interest.
- Upward economy

CONT'D

Steep yield curve
- Investors expect interest rates to rise in future so demand high rate of interest and high rate of return when buying long term bonds.
- This is because economic recovery is normally accompanied by corporation wanting to borrow more money thus increasing it's demand and putting upwards pressure on interest rates.
- Upward economy

CONT'D

Flat yield curve
- Yield of all maturity are close to each other.
- Inflation expectations have decreased.
- Investors are demanding no premium.
- It is a sign of pending or ongoing economy.
- Slow down economy

CONT'D

Humped yield curve
- Short term and long term rates are close to each other.
- It happens when there is an increase in demand or decrease in supply of long term bonds.
- Recession

Inverted yield curve
- Long term rates are lower than short term interest rates.
- Very rarely happens.
- Sign of an upcoming economic slow down.
- Recession

REAL RATE OF RETURN

- RR = ROI - INFLATION RATE
- R = (1 + N) / (1 + I) - 1

- Real adjusted for today's inflation
- Nominal only on paper

Importance
- Forecasting interest rates
- Used for financial intermediary
- Detecting over priced and under priced security
- Indicates trade off between maturity and yield.

FACTORS AFFECTING SHAPE OF YIELD CURVES

- Investors expectations for future interest rates
- Risk premium required

THEORIES RELATED TO SHAPE OF THE YIELD CURVE

- Pure expectations theory

It says that slope of the yield curve reflects only investors expectations for future short term interest rates. Investors expect interest rates to rise in future which causes upward slope of the yield curve.

- The liquidity preference theory

It asserts that long term interest rate not only reflect investors assumptions about future interest rates but also include a premium for holding long term bonds. It

compensates investors for the added risk. Due to this long term yields tend to be higher than short term yields and the yield curve slopes upwards.

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- Preferred habitat theory

It states that in addition to interest rate expectations , investors have distinct investment horizons and require a meaningful premium to buy bonds with maturities outside the preferred maturity or habitat.

It believes that short term investors are more prevalent in the fixed income market and therefore long term rates tend to be higher than short term rates.

YIELD CURVE STRATEGIES

- Bullet – Maturities of all securities are highly concentrated at one point on the yield curve. E.g.. Most bonds of the portfolio maturing in 10 years from now.
- Barbell – Maturities at two extremes say 5 and 25 years.
- Ladder – Equal amount of securities maturing periodically.

KEY INDICATORS

- It is anything that can be used to predict future financial and economic trends.
- They are used to forecast changes in business cycle and economy and use time series for forecasting.
- They are useful to study cyclical expansions and contractions in business activities.
- They are of three types as follows:
- Leading signals future events
- Lagging is one that follows an event
- Coincident occur at the same time as the conditions they signify.

LEADING INDICATORS

They signal changes before changes actually occur.
Indicate both expansion and recession.
Used by policy makers and government.
Top leading indicators are :

1. Stock market (+ , - , bubbles, storm of 2008 overvalued subprime loans and credit defaults swept the market)
2. Manufacturing activity (GDP , Employment , - wholesaler & retailor piling up goods)
3. Inventory levels (demand to rise or lack in demand, stock of inventory)
4. Retail sales (GDP , Employment but does not account the inflow of money used for purchase of goods)

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- Building permit (more construction, employment, supply more than demand , builders bottom line, undervalued real estate prices)
- Housing market (decline is related to building but decline estate investments returns)
- Level of new business start ups (Increase in small business indicate growth)

LAGGING INDICATORS

Lagging indicator shift after the economy changes.

It indicates long term trends. If an indicator that lags recession starts rising, it means that trough has been reached and expansion has began.

Few of the lagging indicators are as follows :

1. Changes in GDP (GDP drops for more than 2 quarters, recession is approaching, artificial increase in GDP if central bank puts in money in the economy)
2. Income and wages (Declining income, reduced employment , problems arise in economy)
3. Unemployment rate
4. Consumer price index (Inflation) – calculated by measuring the cost o9f essential goods and services.

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Inflation encourages spending and investing, which helps an economy to grow. It keeps interest rates at a high level which encourages investments.

Deflation is reduction in cost of living , not always good can indicate economic slowdown as well.

5. Currency strength
6. Interest rates (Interest rate cycle based on central banks interest rate)
7. Corporate profits (GDP , Stock market , can be false as well)
8. Balance of trade – Net difference between the value of exports and imports.(Trade surplus coming in to the country or trade deficit money going out o0f the country)

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9. Value of commodity to US $

Gold and silver are priced in US $

They are viewed as substitutes to US $

When US $ declines , these commodities increase in price since more people buy them as a measure of protection and consider these metals to have an inherent value which does not decline.

E.G. 2001 GOLD $1900 AN OUNCE AS $ PRICE DETERIORATED.

COINCIDENT OR CONCURRENT INDICATORS

They tell us about current economic conditions ie. Rising or declining, growth is good or bad etc.

The few major ones are as follows :

1. No. of employees on non agricultural payrolls
2. Industrial production
3. Real personal income
4. Real mfg. and trade sales
5. GDP
6. Current sales