WEALTH MANAGEMENT 2015 AND BEYOND: TRENDS AND CHALLENGES

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AGENDA

- Trends in Demographics
- Trends in Technology
- Trends in the Wealth Management Marketplace
- Trends in Wealth Management Knowledge & Practice
- Adding Value to Stay Competitive
TRENDS IN DEMOGRAPHICS: IMPLICATIONS FOR PRACTITIONERS

DEMOGRAPHICS

Population Age Distribution 2013

- World
- North America

Population Age Distribution 2050

- World
- North America

Source: United Nations World Population Prospects
DEMOGRAPHICS

- **13.7 million** high net worth individuals globally
- **US$52.62 trillion** in wealth.


DEMOGRAPHICS: **WHERE IS THE WEALTH?**

Wealth Distribution 2013 (US$ Trillion)

North America has 28.3% of Global Investable Wealth of HNWI

Latin America has 14.6% of Global Investable Wealth of HNWI and 32.9% of Global Investable Wealth of UHNWI

DEMOGRAPHICS: WOMEN

“A quiet economic and social revolution is taking place, one that has significant meaning for financial services organizations. It is a revolution of, by, and for women, driven by a quest for more – more time, more value, more peaceful and secure lives.”

Source: Women Want More (in Financial Services), 2009 report by Boston Consulting Group

Control of U.S. Wealth, by Gender

2012 2020 est

51% 67%

Men Women
DEMOGRAPHICS: WOMEN TODAY…

• Control $8 trillion in assets in the US, a figure that is expected to jump to $22 trillion by 2020;

• Live longer and are responsible for more household financial decisions;

• Participate in the workforce and are generating personal income and retirement assets;

• Are poised to inherit from both their families and spouses.
DEMOGRAPHICS: MILLENNIALS

• Also known as “GEN Y”

• Young adults born after 1980

• Control around $2 trillion in liquid assets in the US

DEMOGRAPHICS: MILLENNIALS

• There are about 80 million millennials in the US;

• They spend about $300 billion a year on consumer discretionary goods;

• By the year 2020, millennials will make up HALF (50%) of the workforce.

Source: the 2014 Millennial Impact Report
DEMOGRAPHICS: MILLENNIALS

Millennials are also:

- Cautious
- Distrustful of Wall Street
- Care more about risk than anything else
- Hold a lot of cash

MANY DO NOT SAVE ENOUGH....
WHEN THEY DO INVEST.....

**Millennials**

- Cash: 52%
- Fixed Income: 7%
- Stocks: 13%
- Other: 28%

Source: UBS “Think you know the Next Gen investor? Think again” 1Q 2014

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**DEMOGRAPHICS: MILLENNIALS**

**Savings Breakdown: Millennials vs. Everyone Else**

- Ages 21 to 36: 52% in cash
- All other ages: 23% in cash

Source: UBS Wealth Management 2014
DEMOGRAPHICS: AGE OF ADVISORS

Practice Transition

- In the US, the average age of financial advisors is 50.9;
- 43% are over the age of 55;
- Nearly one-third of advisors fall into the 55 to 64 age range.

Source: Advisor Metrics 2013: Understanding and Addressing a More Sophisticated Population, Cerulli

Image credit: Roger Schullerstrom; InvestmentNews article
DIGITAL INFLEXION POINT: HIGH STAKES

• **Two thirds** of HNWIs “are likely to leave firms that do not allow them to transact digitally”.

• **Nearly two thirds** of HNWIs expect to manage most or all of their wealth relationship digitally in five years and would consider leaving their current firm if an “integrated channel experience” is not provided.

“The digital experience does not start and finish with a fancy interactive website. [Clients] expect their wealth-management experience to be as good as, if not better, than the best that retail – such as Apple – has to offer.” - Sebastian Dovey, Scorpio Partnership*

* Source: Vonnegut: Wealth Management’s Biggest Losers, WSJ

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**DIGITAL INFLEXION POINT: HOW CAN FINANCIAL ADVISERS BEST COMPETE?**

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**DIGITAL INFLEXION POINT: UNDERSTAND, LOBBY, TEST**

**Understand** => Listen. What do your clients want? Any Time, Any Place, Any Device

**Lobby** => Demand the functionality you need.

**Test** => Experience your firm’s technology the way your clients experience them.

Source: Capgemini, WSJ/Vonnegut: “Wealth Management’s Biggest Losers”
ROBO ADVISORS

Automated Portfolio Management Programs

• Web-based firms that invest clients’ money;

• Offer low fees (0.15% to 0.35% of a client’s AUM);

• Use algorithms to create and tweak portfolios;

• Manage about $15.7 billion in client assets (as of July 2014).
ROBO ADVISORS

Growth of new low-cost investment advice start-ups ($ billions, 2014)

April

May

Discretionary Control

Paid Investment Advice

Source: Grant/Estabrook / Corporate Insight

ROBO ADVISORS: SOME OF THE LEADERS

- Wealthfront: $1.25 billion in AUM*
- Betterment: $740 million in AUM*
- FutureAdvisor: $200 million in AUM*

ROBO ADVISORS: WHAT DOES IT MEAN FOR YOU?

- Increased fee pressure
- More transparency
- Need to accommodate a younger generation
- More technology

Source: SEI Advisor Network, "Five Ways Robo-Advisors Will Change the Way Advisors Work"
75% of financial compliance professionals listed cybersecurity as one of the firm’s top issues in 2014, according to a recent survey*

*Source: 2014 Investment Management Compliance Testing Survey
TRENDS IN THE WEALTH MANAGEMENT MARKETPLACE: IMPLICATIONS FOR PRACTITIONERS

TRUST: AN IMPORTANT COMPONENT OF THE FINANCIAL ECOSYSTEM

Providers of Capital

Intermediate

Users of Capital

Groundskeepers:
- Regulators
- SROs
- Universities
- etc.

Traders of Capital

Opiners

Capital

Assets/Securities

Opinions
“From a busted broker with missing customer money to billion dollar trading blunders to lying about LIBOR…”

Swiss regulators opened a probe into a possible cartel between banks.

TRUST: THE CURRENT STATE

What percentage of consumers do you think trust businesses in the financial services industry to do the right thing?

According to the Edelman Trust Barometer, the financial services industry is the least trusted industry globally.

<table>
<thead>
<tr>
<th>Sector</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology</td>
<td>73</td>
<td>79</td>
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<tr>
<td>Automotive</td>
<td>66</td>
<td>70</td>
</tr>
<tr>
<td>Food &amp; Beverage</td>
<td>62</td>
<td>66</td>
</tr>
<tr>
<td>Consumer Packaged Goods</td>
<td>60</td>
<td>65</td>
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<tr>
<td>Energy</td>
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<td>Pharmaceuticals</td>
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<td>Media</td>
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<tr>
<td>Banks</td>
<td>49</td>
<td>51</td>
</tr>
<tr>
<td>Financial Services</td>
<td>46</td>
<td>48</td>
</tr>
</tbody>
</table>
TRUST: WHAT DO INVESTORS LOOK FOR IN AN ADVISOR

CFA Institute and Edelman partnered to understand the state of trust in the investment industry. The study conducted in July 2013 surveyed 1,604 retail and 500 institutional investors in the United States, United Kingdom, Hong Kong, Canada and Australia.

Investors who do not trust the industry are unlikely to:
- Save and invest for their future
- Achieve their long-term financial objectives

A “savings gaps” means:
- Longer working lives
- Lower quality of life
- Intergenerational stress

Social impact

TRUST: THE COSTS OF FAILURE

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- Save and invest for their future
- Achieve their long-term financial objectives

A “savings gaps” means:
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- Lower quality of life
- Intergenerational stress

Social impact
STATEMENT OF INVESTOR RIGHTS

Demanding that financial professionals abide by these rights helps you build trust in the person and/or firm you engage with, and thereby collectively restore trust, respect, and integrity in finance.

WHEN ENGAGING THE SERVICES OF FINANCIAL PROFESSIONALS AND ORGANIZATIONS, I HAVE THE RIGHT TO...

1. Honest, competent, and ethical conduct that complies with applicable law;
2. Independent and objective advice and assistance based on informed analysis, prudent judgment, and diligent effort;
3. My financial interests taking precedence over those of the professional and the organization;
4. Fair treatment with respect to other clients;
5. Disclosure of any existing or potential conflicts of interest in providing products or services to me;
6. Understanding of my circumstances, so that any advice provided is suitable and based on my financial objectives and constraints;
7. Clear, accurate, complete and timely communications that use plain language and are presented in a format that conveys the information effectively;
8. An explanation of all fees and costs charged to me, and information showing these expenses to be fair and reasonable;
9. Confidentiality of my information;
10. Appropriate and complete records to support the work done on my behalf.

“When stated as a percentage of assets, average fees do look low — a little over 1% of assets for individuals and a little less than one-half of 1% for institutional investors. But the investors already own those assets, so investment management fees should really be based on what investors are getting in the returns that managers produce. Calculated correctly, as a percentage of returns, fees no longer look low. Do the math. If returns average, say, 8% a year, then those same fees are not 1% or one-half of 1%. They are much higher — typically over 12% for individuals and 6% for institutions.”

Source: Charles Ellis, Enterprising Investor Blog, 2012
**FEES: FEE STRUCTURES**

<table>
<thead>
<tr>
<th>Fee Structure</th>
<th>Pros and Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction-based fees</td>
<td>Pros: Transparent, low cost for buy &amp; hold investors, firm has an interest in providing good execution and service&lt;br&gt;Cons: Conflicts of interest to sell more products, fiduciary interest?, not based on performance</td>
</tr>
<tr>
<td>AUM-based fees</td>
<td>Pros: Transparent, predictable, lower incentive to use expensive/third party products&lt;br&gt;Cons: Conflicts of interest to grow/retain assets, bias toward larger clients, low performance incentives</td>
</tr>
<tr>
<td>Performance-based fees</td>
<td>Pros: Alignment of investor and client interests, directly related to performance&lt;br&gt;Cons: Fees unknown at outset, potentially large fees, can lead to increased risk</td>
</tr>
<tr>
<td>Flat or Project based fees</td>
<td>Pros: Unbiased, transparent&lt;br&gt;Cons: Incentives to recommend additional projects/work, incentives to take on more clients</td>
</tr>
</tbody>
</table>

**INVESTMENT TOOLS & PRODUCTS: ACTIVE VERSUS PASSIVE INVESTING**

![Graph showing comparison of Total Passive Funds and Total Active Funds](image.png)
INVESTMENT TOOLS & PRODUCTS: GROWTH IN ETFS

ETF Share of Total U.S. Trade Volume
March 2000–Sept. 2011 (3-months average)

Source: Credit Suisse Portfolio Strategy

INVESTMENT TOOLS & PRODUCTS: CORRELATIONS

Stocks and Real Estate Investment Trusts
INVESTMENT TOOLS & PRODUCTS: LIQUID ALTERNATIVES

“The liquid alternatives space grew by 43% in 2013, while hedge funds saw their assets increase by 15% to reach $2.6 trillion…. However, liquid alternatives are still in their infancy and comprise just 1%, or $137 billion of the $13.2 trillion presently controlled by the entire US mutual funds industry…. …estimated assets controlled by liquid alternatives will reach between $650 billion and $950 billion by 2018.”

Source: COOConnect/Barclays Prime Services: Developments and Opportunities for Hedge Fund Managers in the 40 Act Space.
INVESTMENT MANAGEMENT PROCESS:
WHERE IS VALUE ADDED?

Source: Tools & Techniques of Investment Planning, 3rd Ed., Leimberg, Doyle, Robinson and Johnson

INVESTMENT MANAGEMENT PROCESS:
WHERE IS VALUE ADDED?

91 Large Corporate Pension Plans
40 quarters of data 1974-1983

<table>
<thead>
<tr>
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<th>Variation of Returns</th>
<th>Average Returns</th>
<th>Minimum Return</th>
<th>Maximum Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic Asset Allocation</td>
<td>93.6%</td>
<td>10.11%</td>
<td>9.47%</td>
<td>10.57%</td>
</tr>
<tr>
<td>Tactical Asset Allocation</td>
<td>1.7%</td>
<td>-0.66%</td>
<td>-2.68%</td>
<td>0.25%</td>
</tr>
<tr>
<td>Investment Selection</td>
<td>4.2%</td>
<td>-0.36%</td>
<td>-2.90%</td>
<td>3.60%</td>
</tr>
<tr>
<td>Interaction &amp; Other</td>
<td>0.5%</td>
<td>-0.08%</td>
<td>-1.17%</td>
<td>2.57%</td>
</tr>
<tr>
<td></td>
<td>100.0%</td>
<td>9.01%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

INVESTMENT MANAGEMENT PROCESS:
WHERE IS VALUE ADDED?

Returns on Passively Managed Portfolios (Net of relatively smaller fees, expenses and/or time expended)

\[ \text{Returns on Actively Managed Portfolios} = \text{Market Index Returns} - \text{Aggregate Fees and Expenses for Management of all Portfolios} \]
“ONGOING ACTIVITIES OF A GOOD WEALTH ADVISOR” SOURCE: GREYCOURT & CO.

- Appropriate strategic allocation
- Avoiding behaviorally driven mistakes
- Tactical adjustments
- Opportunistic investments
- Selecting best-in-class investment managers
- Asset location
- Managing taxes
- Maintaining discipline in market turbulence
- Reporting timely and accurate results

“THE ADDED VALUE OF FINANCIAL ADVISORS”

- Portfolio Construction
  - Asset allocation using broadly diversified mutual funds/ETFs > 0%
  - Use of low-cost index-based products 0.45%
  - Asset location between taxable and tax-advantaged accounts 0 to 0.75%
  - Total-return versus income investing > 0%
- Wealth Management
  - Regular rebalancing 0.35%
  - Spending strategy for drawdowns 0 to 0.70%
  - Behavioral coaching 1.5%
- Total about 3.0%
PRIVATE WEALTH MANAGEMENT: THE FUTURE IS HERE

**Tax-Advantaged Investing**
- After-Tax Wealth Accumulation
- Tax-Adjusted Asset Allocation
- Asset Location
- Tax Loss Harvesting

**Retirement Planning Today**
- Sustainable Retirement Withdrawals
- Longevity Risk
- Liability Driven Investment: Institutional Pension Plan Strategies Applied to Individuals

**Life Balance Sheet Approach**
- Human Capital vs Financial Assets

PRIVATE WEALTH MANAGEMENT: LIFE BALANCE SHEET

Source: Adapted from Willcox, Hermitz, and di Bartolomeo (2004, 11)

CFA Institute
MOST UHNWI GLOBALLY DERIVE THEIR WEALTH FROM A PRIVATE BUSINESS


PRIVATE WEALTH MANAGEMENT: LIFE BALANCE SHEET OVER TIME

ADDING VALUE TO STAY COMPETITIVE

Build Strong Client Relationships
- Build trust through your business practices and actions
- Understand your clients/prospects needs including communication (technology) preferences

Compete on Value Provided not on Cost
- Wealth Management, not just Investment Management
- Differentiate yourself – what do you have to offer that robo-advisors cannot?
- Focus on the asset allocation decision matched to client objectives, preferences and life balance sheet (including planning for a concentrated business interest). Look for opportunities to maximize returns after taxes and expenses – control expenses and tax manage portfolios
- Focus on retirement accumulation and distribution strategies to take advantage of demographic trends
- Help clients understand the need to save and invest for the future
- Use all of the tools in the toolbox.
- Higher correlations = more diversification required.
- Insurance as part of the portfolio

PRIVATE WEALTH MANAGEMENT: WHERE TO ADD VALUE