Turning Data into Client Advocacy
Harnessing the Power of Performance Reporting

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In early 2008 (that is, before the financial crisis hit), IBM Global Business Services of New York released results from a survey of 1,300 investors with at least $500,000 or more in investable assets (IBM 2008). Based on the answers to a series of questions, IBM categorized each respondent as either an advocate of, apathetic toward, or antagonistic about their wealth managers and bankers.

The results—especially given that the survey was conducted before the financial crisis—were not encouraging. Only 43 percent of respondents were advocates of their wealth managers, while the remaining 57 percent were either neutral or negative. Bankers fared even worse—only 24 percent of respondents were advocates while 76 percent were either neutral or negative.

How investors felt about their wealth managers mattered because the same survey indicated that 82 percent of advocate clients reported giving 70 percent to 100 percent of their wealth management business to their preferred firm—more than twice as much as apathetic clients gave to their firms. In addition, 90 percent of advocates agreed that their wealth management firms were a “trusted advisor” and only 6 percent reported being sensitive to the level of wealth management fees.

These survey results map nicely to the results of a separate, multi-industry study that suggests that the “magic metric” determining any firm’s success, regardless of industry, is the level of client advocacy—the degree to which clients are active promoters and referral sources for that firm (Reichheld 2003).

What, an advisor might ask, does any of this have to do with performance reporting? Digging back into the IBM survey, we find that only about 30 percent of apathetic investors agreed that “the quality of reports [met] expectations.” In a 2007 study, industry consultant Chatham Partners found that of the top 10 service-related drivers of satisfaction as ranked by institutional investors, the #2 response was “clarity of investment reports” and the #5 response was “timeliness of investment reports.”

Additional evidence that industry competitors are awakening to the importance of performance reporting comes from a mid-2011 industry survey of approximately 180 wealth advisors by the data aggregation firm ByAllAccounts. This survey found that close to 40 percent of respondents indicated that they use some form of outsourced portfolio accounting system and 25–27 percent of respondents indicated that they outsource the data aggregation, portfolio reconciliation, and performance reporting aspects of their practices.

Given all this, how might wealth advisors use performance reporting to differentiate themselves in an increasingly crowded—and competitive—high-net-worth market place? This article focuses on what might be contained in an exceptional performance measurement and reporting solution. How the performance report looks, the information it conveys, and the degree to which it helps clients understand the value advisors are adding to their financial lives can make the difference in landing and keeping high-net-worth clients and, more importantly, potentially turning those clients into referral-prone advocates.

The Value of a Good Performance Report

Many wealth managers overlook or fail to recognize that the client performance report is one of the few physical manifestations of what the advisor is actually doing. The report represents the perfect opportunity to remind the client in a very tangible way of the value the advisor is bringing to the table. Clients are barraged with data on a daily basis—from media, peers, and, potentially, other advisors. A performance report creates an opportunity to physically connect with clients at an in-depth level in a comprehensive but easy-to-visualize way. As such, the report should achieve the following goals:

Act as a reminder of the agreed-upon investment plan. Most wealth managers, when first retained by a client, go through the process of creating a detailed investment policy and wealth management plan. This plan covers such issues as cash-flow requirements, risk tolerance, growth and terminal value goals, time horizon, tax issues, and so forth. Good advisors make this a consultative, interactive endeavor with clients, and the results are a mutually agreed-upon comprehensive roadmap of where the client and advisor plan to go together.
But once that plan is agreed upon and implemented, how do the client and advisor keep track of how they are doing? Or identify problem spots or obstacles that may arise along the way? The answer should be the performance report. But, instead, many clients receive multiple statements with lists of the securities they own across disparate accounts, perhaps with some pie or bar charts included, but with little or no reference to the original plan that went into creating their portfolios. In other words, they are given data rather than information, meaning, and advice. The report should convey the path that a financial plan is taking and compare it to the planned path that was agreed upon up-front.

Present an objective assessment of how the plan is performing. How is the overall plan performing versus the original objectives? And what is the performance of each and every investment in the client's portfolio?

Many performance reports contain information on only the managers or accounts for which the advisor is directly responsible. The fact is, however, that most high-net-worth clients have more than one advisor or manager and, frequently, multiple custodial or brokerage accounts. From a portfolio-management standpoint, generating a report that is limited to one segment of the total portfolio limits the analysis of investment performance. From a practice-management perspective, how have you differentiated yourself?

If you fail to report on 100 percent of a client's total portfolio, you run the risk of being a competing advisor but not the trusted advisor—the advisor who gets active and enthusiastic referrals. A primary objective of any wealth manager should be to make clients' financial lives easier. Given this, a truly added-value performance report should incorporate and consolidate the entirety of the client's investment portfolio, regardless of investment, entity, original data source or quality, or custodian. All—100 percent—of client investment data should be gathered, consolidated, reconciled, and “normalized” to ensure accuracy. Only then can the consolidated performance report provide the client with one master source of information about how the portfolio is performing on an absolute and appropriate benchmark-relative basis. From the advisor's perspective, delivering a comprehensive report on the entire portfolio makes it less necessary for the client to access other advisors for information—thereby serving to increase the depth and “stickiness” of the client relationship.

Present information that helps explain the factors driving portfolio performance. A good performance report should lay out in a comprehensive fashion the causes and effects of portfolio performance. Beginning with macro-economic trends and shifts, the report should drill down from the performance of the overall portfolio to the performance of each asset class, to each manager within each asset class, and to the benchmark-specific performance for each manager. Only by reporting this level of detail can the client and advisor identify the contributors to outperformance or underperformance and move to make the changes necessary to bring the client's portfolio back onto the proper path. The information provided with this level of detail also allows the advisor to add value, where appropriate, through tax management—one of the key differentiating factors for taxable clients.

Offer a clear illustration of the value the advisor adds. Beyond performance analysis, the report should clearly illustrate where and how the advisor is adding value (and thereby justifying a fee). Regardless of the advisor’s unique value proposition—asset allocation expertise, cost and tax management, active manager selection, tactical portfolio rebalancing, constructing portfolios that meet specific agreed-upon investor objectives, or the intelligent use of nontraditional investment strategies within the portfolio—the performance report should be flexible and customizable enough to allow the advisor to highlight and demonstrate the value added to the client's financial life.

By serving these four purposes—providing a reminder of the overall investment plan, an objective assessment of how and why the plan is performing, and an illustration of advisor value—the performance report moves beyond numbers on a page. It provides meaning and insight, and it becomes a truly useful tool for both client and advisor. This tool helps the client to see the value added by the advisor and allows the advisor to continually monitor and refine the client’s overall wealth management plan.

What a Performance Report Should Contain

Here is a summary of what a comprehensive performance report should contain, segmented into a descending hierarchy from overall portfolio performance to security-specific performance.

Generating a report in this fashion allows clients to focus on the level of detail that each deems important. Many clients simply want to know what they are worth. Comparative figures can detail how the portfolio's value at the end of the period has changed from the value at the beginning of the period. Other investors may want more-detailed information that explains each manager’s performance and the contributors to that performance. By presenting the information in macro and micro formats, where each successive segment of the report goes into increasing levels of detail, the performance report becomes a flexible tool that an advisor can use according to each client’s objectives, knowledge base, level of sophistication, and attention to detail.

For example, a comprehensive performance measurement report might segment information into the following increasingly specific reviews:
Portfolio—examines the performance of the overall capital invested by focusing on the value added from asset allocation decisions, risk-adjusted performance, and active management decisions at the overall portfolio level.

Super class—segments and analyzes the portfolio at the level of its equities, credit strategies, alternatives, and cash. This approach might be particularly appropriate for advisors who use multi-cap, multi-asset, multi-strategy, or unconstrained asset managers for whom a more segmented analysis would be difficult or misleading. A super-class portfolio hierarchy allows the advisor to report on a bucketed portfolio construction approach; for example, the super classes might be called “high volatility,” “low volatility,” “market participation,” “aspirational,” “lifestyle maintenance,” “inflation protection,” etc. Such objective-driven buckets are not well-supported by a traditional asset class or style hierarchy.

Asset class—reviews how each specific asset class performed relative to its benchmark (which, if “rolled up” would show how the overall portfolio is performing compared with an asset class-weighted benchmark portfolio).

Asset style—examines how each asset style (e.g., growth, value, or core) within each asset class performed.

Manager—examines how each manager within each asset style performed relative to an appropriate benchmark (net of fees and taxes) and relative to peer managers within each particular style. At this level of the portfolio, it is critical to track performance based on the actual investment. If the investment is a separate account, then all the securities in the account should be treated as a single investment by a single manager. If it is an exchange-traded fund (ETF) or mutual fund, then the individual security is the investment. If it is a limited partnership (LP), then the LP is the investment. If it is a sleeve within a unified managed account (UMA), then all the securities in the sleeve should be aggregated into a single investment. An investment may be a fractional ownership of another investment (i.e., a partnership interest). If so, then the investor may want to view this fractional ownership in two ways: 1) How is the underlying investment performing? and 2) how is the fractional ownership in that underlying investment affecting the performance of the investor’s overall portfolio? The point is that the reporting system must be flexible enough to track performance on portfolio holdings in the same way that those holdings have been invested.

Security-specific—if needed or desired, this final level of analysis examines how each specific security within each manager’s portfolio has performed.

Let’s briefly describe the information that might be included in each of these levels of analysis.

Portfolio Analysis

A portfolio overview page (figure 1) provides a broad summary of what transpired over the previous quarter and may include the following information:

- Total portfolio value (including all investment assets, not just assets directly under the management or advisement of the advisor), with information about both time- and dollar-weighted returns to illustrate
the timing and the impact of contributions and withdrawals;

- A comparison of the net capital invested with the value of the portfolio over time; and

- A comparison of portfolio performance with an index-based, asset class-weighted portfolio to illustrate the benefit added from active manager selection.

A summary that illustrates risk-adjusted portfolio performance (figure 2) might follow the portfolio overview page. This analysis helps the client visualize the value the advisor has added from both asset allocation and active manager selection decisions, on a risk-adjusted basis.

The next step in the portfolio-level analysis might be a portfolio vs. policy review. This information compares the current allocations within the client portfolio to the agreed-upon allocations in the investment policy statement. A portfolio vs. policy review will identify where the portfolio is over- or under-weight relative to policy, with the purpose of driving an informed discussion regarding potential rebalancing or reallocation decisions.

Asset Class and Asset Style Review

Once the overall portfolio performance has been reviewed (i.e., How is the plan doing?), it is appropriate to examine (and illustrate) the factors contributing to that performance (i.e., Why has the plan performed as it has?).

A trailing returns summary is one useful way of presenting this information (figure 3). The trailing returns summary shows detailed time-weighted performance information on every manager, fund, or investment segment within the portfolio, for various time periods. Each manager’s performance is summarized, then “rolled up” into the manager’s asset style (core, growth, or value) and then “rolled up” again into the manager’s asset class (which then could be “rolled up” again into super

FIGURE 2: “ALPHA-STAR” PERFORMANCE MEASUREMENT

FIGURE 3: TRAILING RETURNS SUMMARY
The ending market value for each manager should be the same as the ending values shown in the trailing returns summary on the previous page, but this dissection of that ending market value allows the investor and advisor to identify the specific contributing factors to that value. As a final step in the asset class review, the report might summarize a portfolio history of all capital inflows and outflows, allowing the investor to track how and when cash entered and exited the portfolio and for what purposes.

Asset Style and Asset Manager Review

Once the overall asset classes and styles have been reviewed, the next level of analysis examines how each asset style has performed individually, including the performance of each manager within each style (figure 5).

There are two relevant comparisons when examining asset style and individual manager performance. First, how did each of the individual managers perform relative to the appropriate benchmark or index? Second, how did that manager perform relative to peer managers within the same asset style? With this level of analysis the investor and advisor can learn the degree to which the portfolio's overall performance has been impacted by the performance of one individual manager or group of managers.
Note, however, that individual manager performance is frequently the primary focus for individual investors—a focus that can lead investors to chase the current hot manager, lose sight of the overall investment plan, and result in the worst form of market timing.

Placing individual manager performance this deep in the performance report sends the message that the plan, and discipline with respect to the plan, drives overall performance. (Still, the advisor must reinforce this message at each client meeting.) In this section of the report, a one-page summary for each manager may include the following information:

- Manager performance on an absolute basis, since inception, broken down by investment gains and losses, interest and dividends, fees, and contributions to and withdrawals from that manager
- Manager performance compared with a relevant benchmark index and an appropriate peer group of managers

Performance versus the benchmark might be depicted in several ways. A manager activity summary breaks down manager performance into beginning market value, income, expenses, gains/losses, contributions/withdrawals, and ending market value. A trailing returns comparison illustrates how the manager has performed against a relevant benchmark over multiple time periods. An index comparison illustrates a manager’s cumulative performance month-by-month against a relevant benchmark.

Upon the investor’s request, a performance report then might drill down one additional level and look at the performance and unrealized gain or loss of each individual security that makes up the portfolio for each manager. This may be a more appropriate level of analysis for the advisor—who could use the information to help manage taxes—than for the investor. For the investor, whether or not Stock A or Bond B went up or down is of minimal importance compared with the performance of the overall portfolio.

“*The Extra Mile*”

A differentiated performance report must be flexible enough to support two distinct trends within high-net-worth wealth management.

First, high-net-worth portfolios frequently include a significant allocation to nontraditional or alternative investments, which often are “housed” within limited partnerships (LPs). Gathering, reconciling, and reporting on LP investments is not easy, and LPs bring their own nuances to the table. For example, different fee structures and high-water marks mean that LPs must be valued rather than priced. Further, holdbacks and side pockets may be part of an overall LP investment but they should be tracked separately. For clients who invest in alternative investments, then, good performance reports also should include:

- Total exposure to alternative investments by fund and by investment entity (as a way of evaluating concentration risk); note that understanding exposures and concentrations is
critical for the investor as well as the advisor, who may have multiple clients invested in the same strategies;
• Market value updates derived from the fund manager (i.e., not dependent on potentially stale custodial pricing);
• The ability to update market values and/or enter estimates to prepare for client meetings despite frequently delayed performance numbers; these estimates must be timely (e.g., within 15 days after the end of a given reporting period) so that a report can be generated while the information is still relevant, but care must then be taken to make sure that final values replace the estimates once they are available;
• Transparency into whether market valuations reflect carried values, estimates (and whose estimates), or final actual value; and
• The ability to report on private equity and other illiquid assets, including capital commitments, percent of commitment called, unfunded commitment, distributions, and internal rates of return prior to distribution (figure 6); depending on client preference and availability of timely pricing information these investments may be reported “above the line” (i.e., at a reasonably accurate current market value) or “below the line” (i.e., at a purchased price or historical carried value).

A second trend within wealth management is the desire by both client and investor to see investment portfolios constructed, managed, and reported on within a goals-based framework (Chhabra 2005). This means proposing, constructing, managing, and reporting on client portfolios by evaluating how the portfolio is helping the client to meet specific portfolio objectives (e.g., lifestyle maintenance, minimum net-worth parameters, aspirational goals, etc.) rather than simply reporting...
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by asset class, individual managers, or modern portfolio statistics (figure 7).

A fuller treatment of goals-based investing is beyond the scope of this article. Regardless, the architecture of a performance report must be flexible enough to support any variation of a goals-based wealth management approach.

Summary and Conclusions

Wealth managers cannot control investment returns on a macro basis because they cannot control the markets. For this reason, a business model that focuses solely on investment performance is fundamentally flawed because investors drawn in by current returns are likely to depart should those returns fall off.

A more successful, long-term business model calls for the following:

• Collect, normalize, and report on 100 percent of all client assets, regardless of custodian or advisor; this will prove to be one of the best client-acquisition and retention strategies an advisor will ever employ;
• Focus on those performance factors that can be controlled with more certainty—asset allocation, beta management, fees, and taxes; and
• Remind clients that it is the investment plan—i.e., the setting of goals, the construction of a portfolio that has the highest probability of meeting those goals, and the disciplined implementation, review, and refining of those goals—that ensures long-term success.

Properly constructed and used, the performance report supports this business model and acts as the physical representation and reminder of the underlying plan and the advisor’s value added to that plan. This article has focused on the contents of a good performance report and how it can help an advisor add value for an individual client. Advisors should understand and appreciate, however, that such a comprehensive performance reporting solution can help advisors manage entire practices.

Investors may be drawn to an advisor based on performance, but they remain clients and become advocates because they are constantly and variously reminded that the advisor is adding value. A performance report that performs this function is an indispensable tool for investor and advisor alike.

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Endnotes

1 For a copy of the cited research, contact Chatham Partners at http://www.chathamllc.com/. A summary of the survey results may be found on FundFire (subscription required), here: http://fundfire.com/c/35294/1852?referrer_module=searchResults&module_order=23&q=Chatham+Partners&sort_by=date.


4 The “Alpha-Star” metric is a useful tool in illustrating risk-adjusted performance, developed by Wharton professor (and CIMA program instructor) Richard Marston (2004).

References


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