

ONE YEAR LATER

Asymmetrical Relationships for Investment Managers Are Over

By Philip Kessler, JD

Efficient, low-cost, transparent automated investment management and client communication platforms, properly deployed and utilized, promote client engagement with the underlying firm and, more importantly, between clients and their financial future. This second benefit, financial self-actualization, begs us to use automated platforms for all clients, not just those who are young, have fewer assets, or have less-complicated financial lives. Remember, your clients didn't hire you because you can string together a dozen mutual funds and call it investment management. They hired you to provide them with a beneficial financial outcome.

The impact of automation, however, has been a shock for the wealth management industry, which historically has wrapped itself in a warm blanket of asymmetry with its clients with very little technological or product advancement.

This article follows up on an interview I participated in for the March/April 2017 issue of *Investments & Wealth Monitor*,¹ which focused on firms that had “embraced digital-advice platforms.” My firm, SWS Partners, has certainly “embraced digital,” but I can't say that we consider the Schwab platform we use, or any competing digital platform, as “advice.” For all of its sophistication, a platform such as Schwab's Institutional Intelligent Portfolios (IIP) does not provide advice, but it does provide a very sophisticated

way to implement the customized advice of a human advisor.

AUTOMATION IS THE FUTURE

SWS Partners has used automated investment management across our client base since our inception in 2014. None of our founders came from an automated investment background, but we all realized that automation is the future for our industry. Therefore, we have avoided the need to remake our firm or reimagine our business model, like many existing registered investment advisors. As Sir Richard Branson once said, “Be open to change or you will be left behind.”²

Whether you like it, believe in it, or are afraid of it, technology-driven change is upon us. In just the past three years, technology has driven down costs, exposed conflicts of interest, and dramatically accelerated the pace of change in an industry that is accustomed to methodical change if not outright stagnation. Many of the technological advances we are seeing are being driven by technology firms, but the main driver is the investing public. There is a hunger among investors of all ages for ease of use, mobility, transparency, and, most importantly, engagement. An investment manager can learn a lot from the likes of Amazon or Netflix about personalizing communication and making sure it is in the appropriate context. These firms and the way they do business have thrust investment managers into a new reality that includes, for example, the following:

No more segments. With the implementation of automated platforms, the historical model of using minimums to segment clients is no longer viable or advisable. As such, SWS Partners doesn't segment clients by the size of their accounts or their ages or their sophistication. Instead, we provide an à la carte menu of services that allows clients control over how they plan for and manage their wealth. Every service and its cost are clearly defined so that clients can understand how much they are paying for each service they use.

Financial planning for all. Unlike many of our competitors, SWS Partners doesn't require that a client have a minimum balance before we will provide financial planning. We tell prospective clients that they can be financial planning clients without being investment management clients, but they cannot be investment management clients without being financial planning clients. (It has always fascinated me that financial advisory firms treated planning as the least valuable thing they offer.)

Fintech thought leader Paolo Sironi argues that for wealth management firms it's “go digital or die.” Such a provocative statement may be fear-mongering, but it should not go unheeded. Sironi points out, “Nowadays, the unveiling of the asymmetry of information is forcing wealth managers to rethink their product-driven approach at a time of declining margins and establish a healthier relationship with final

customers based on clearer client/ portfolio-centric methods.”³ In other words, the wealth management firms that will survive and thrive will be the ones that embrace automation in both their investment operations and digital delivery.

A tax-efficient platform utilizing low-cost indexes to manage diversified portfolios in real time on an as-needed basis renders a comparatively high-fee, tax-inefficient pooled investment vehicle suboptimal at best and inappropriate at worst for the client. A skillfully constructed portfolio is important, but asset allocation portfolios have been commoditized and therefore lack the value they once had in the marketplace. Many firms grappling with whether to implement automated platforms are using traditional platforms and mutual funds to invest their clients’ money. Their long-standing reliance on mutual fund portfolios as a value proposition has a lot of inertia. But the very existence of these firms is at stake given commoditization and evidence that the primary tool for analyzing mutual funds is faulty.⁴ If investment management is meant to provide clients with the best opportunity to reach their goals, then automation is the future of investment management.

BUT AUTOMATION IS NOT ADVICE

We don’t consider platforms such as IIP to be automated advice. IIP’s primary value is providing rebalancing and tax-loss harvesting in the most efficient and beneficial manner possible. Automation maintains clients’ asset allocations, but financial advisors take responsibility for product due diligence and selection as well as portfolio construction.

AUTOMATION RECONFIGURES YOUR STAFF

We staff our business differently because of our aggressive adoption of automation. No one at SWS Partners has a book of business and we do not segment our clients by advisor. All our clients are clients of the firm and have access to all

members of the firm as their needs may dictate. We can take this approach because our use of technology across our business allows us to efficiently manage our time and our clients’ time.

Our technology platform provides clients with 24/7 access to all pertinent information about their investment accounts, so we spend our time advising clients about the important issues rather than helping them merely understand what is happening in their portfolios. Therefore, our staff includes more professionals who support our advice model and fewer with an administrative or operational emphasis. Our value proposition is advice, not legacy processes or procedures that can and should be automated. As margins continue to erode, we think this business structure will allow our firm to stand out.

We have found that clients, regardless of age or station in life, want their planning questions answered by the most-qualified person available. The key is being an empathetic person, not an algorithm. That may mean working with an advisor with 20 years of experience on complex issues related to multi-generational planning or getting retirement planning advice from our 20-something financial planner when that meets their needs. As Michael Finke, PhD, CFA®, dean and chief academic officer at The American College of Financial Services, has pointed out:

*At some point, we demand an empathic human who is compassionate and capable of coming up with solutions that account for our emotional and our quantitative needs. Research even shows that we prefer getting an imperfect recommendation from a human doctor to the perfect recommendation from an algorithm.*⁵

Age may be a common ground for connection between client and advisor, but it’s not necessarily for the reasons one may think. We find that SWS clients find

comfort in the fact that the average age of a member of our firm is the mid-thirties and, therefore, we will be with that client and their family for the foreseeable future. When you consider that the industry is aging out faster than it is adding new talent the advantage of youth is clear.⁶

AUTOMATION CHANGES CLIENT-ADVISOR INTERACTIONS

We have found that our automated platform has changed the conversations we have with clients. Now that clients can see what they own, make, and pay, clearly and concisely, on their own time, they can easily find the answers on their own to common questions. Further, because they can see the actual performance of their portfolios in real time, when the inevitable market shock happens they need less hand-holding. For example, when Britain voted on Brexit, we didn’t get a single phone call about portfolio performance. We asked clients why they didn’t call, and the answer was almost universal: They could see that their portfolios were reacting the way they expected and they did not feel the need to dwell on the market volatility.

Investment management on automated platforms has become the process by which we implement our advice to clients. It is the commodity portion of what we do for clients. This is a significant break from the industry standard of selling clients on the idea that the value they are paying for is the ability of their broker or advisor to deploy the client’s money in a mutual fund portfolio. The true value, and the value that investors will pay for, however, is knowing whether they can maintain their lifestyles for the rest of their lives. By implementing financial advice through an automated platform, we provide clarity of information and transparency that allows clients to stop worrying about the markets and focus on what matters, their future.

Many investors are still getting information and analysis about their financial planning and investment performance

through monthly reports and quarterly meetings, so one can see where the pressure is being applied by automation. Our clients often tell us how much they appreciate the ability to remotely follow their accounts and the progress of their financial plans. Having complete and real-time information via an app increases client engagement with the account and increases the likelihood of success. As a result, we are talking with clients more about their life goals and how to achieve them.

AUTOMATION MAKES ADVISORS MORE COMPETITIVE

All industries, ours included, are competing for a shrinking slice of our clients' time and mindshare, so it is more important than ever that advisors be able to meet clients on their own terms.⁷ Technology and entertainment companies have conditioned customers to expect that their information will be available when they want it, in a form they can easily and quickly consume on the move. This ease of access has increased the value placed on the presentation of information. The newspaper industry is a striking example. Today's modern news consumer gets headlines from an algorithm, which chooses articles based on an individual's prior choices. No longer does one take the time to read through a paper to locate information of interest. Let's not presume that the dissemination of investment advice or reporting should be any different.

SUMMARY

Advisors need to take steps to prepare their practices for the changes that are impacting the industry. They should understand clearly who they are as advisory firms and where they want to go over the next five to 10 years. The industry changes we are seeing, such as downward pressure on fees, a demand for transparency, and the expectation of on-demand service, are only going to accelerate. For some firms, this is an opportunity to transform their businesses and accelerate into the future. For

others, it will lead to an understanding that the firm cannot remain viable. Those in the latter camp will be confronted with investment management's commodification and its impact on the value of their businesses. Don't expect there to be a multiple paid for a business that will require a wholesale change to the existing investment management and fee structure.

For too long automated investment management or automated advice, as the case may be, has been just for the small client with few investable assets. It has been viewed as a low-fee and low-value platform. But the youngest clients with the fewest assets should not be the only clients with access to the lowest fees, most efficient platform, and the best chance to meet their goals and objectives.

We are in a period of rapid and immense change. The impact of technology will only continue to accelerate the pressure on financial advisors to adapt. Today we are facing destruction of the idea that investors will continue accepting the same opaque high-fee business models of the past.

Tomorrow it may be the replacement of human advisors altogether by artificial intelligence and chatbots.⁸ Regardless, the successful firms will be able to constantly adapt to every sophisticated

technological advancement. As retail legend Les Wexner once put it, "If you stop to smell the roses, you get hit by a truck." ●

Philip Kessler, JD, is founder/managing partner of SWS Partners, LLC. He earned a BS from the University of Toledo and a JD from the University of Dayton School of Law. Contact him at philip.kessler@swspartners.net.

ENDNOTES

1. "An Interview with Michael Heburn, Philip Kessler, and Cam Goodwin: Charles Schwab Panel—Automated Advice," *Investments & Wealth Monitor* 32, no. 2 (March/April 2017): 36–40.
2. "There is nothing permanent except change," Heraclitus (535–475 BC).
3. Paolo Sironi (2017), *Fintech Innovation: From Robo-Advisors to Goal Based Investing and Gamification* (West Sussex, UK: John Wiley & Sons, Ltd.).
4. Kirsten Grind, Tom McGinty, and Sarah Krouse, "The Morningstar Mirage," *Wall Street Journal Online* (October 25, 2017), <https://www.wsj.com/articles/the-morning-star-mirage-1508946687>.
5. Michael Finke, "Making the Right Tech Moves," *ThinkAdvisor* (October 2, 2017), <http://www.thinkadvisor.com/2017/10/02/making-the-right-tech-moves?ref=hp-features>.
6. Melanie Waddell, "43% of Advisors Older than 55: Cerulli," *ThinkAdvisor* (January 21, 2014), <http://www.thinkadvisor.com/2014/01/21/43-of-advisors-older-than-55-cerulli>.
7. Eliot Brown, "Future of Tech and Media: Waging a War for People's Time," *Wall Street Journal* (October 17, 2017), <https://www.wsj.com/articles/michael-wolf-whats-next-for-tech-and-media-in-2018-1508258936>.
8. Elliott Krause, "This Robot Will Handle Your Divorce Free of Charge," *Wall Street Journal Online* (October 26, 2017), <https://www.wsj.com/articles/this-robot-will-handle-your-divorce-free-of-charge-1509022800>.