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ADVISOR OF THE FUTURE

Advisor Alpha

By Anthony B. Davidow, CIMA®, Todd Thomson, and Scott Welch, CIMA®

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The following is an edited transcript of a recorded conversation from June 2017 entitled "Adding Advisor Alpha," part of the series "D:Talks," which covers a wide range of wealth management issues, hosted by Dynasty Financial Partners.

The panelists were Tony Davidow, alternative beta and asset allocation strategist at the Schwab Center for Financial Research, and Scott Welch, Dynasty's chief investment officer. The moderator was Todd Thomson, Dynasty's chairman of the board.

Davidow is a former member of the Investments & Wealth Institute Board of Directors and Welch is a current member. Both serve on the editorial advisory board for Investments & Wealth Monitor.

Thomson: Welcome everyone, this is Todd Thomson and I'm hosting our conversation today with Scott Welch, Dynasty's chief investment officer, and Tony Davidow, asset allocation strategist for the Schwab Center for Financial Research.

The topic today is "Advisor Alpha." We are in a really interesting phase of the wealth management space. As the investment consulting business evolved into the wealth management business over the past 20 or 30 years, the focus has really evolved to a much broader set of services—opportunities for advisors to add alpha beyond just investing—and clients are beginning to understand that.

Tony, I'd love to get your point of view on this evolution, including such things as tax optimization to behavioral finance and anything in between.

Davidow: A paradigm shift is going on in the industry where the alpha is now coming from the advisor. For many years advisors spent all their time and energy trying to find managers that outperformed the market over time (alpha), but now an advisor's value is helping clients achieve their goals, dreams, and aspirations. They use an expanded tool box that includes active and passive investments—and traditional and alternative investment strategies. Alpha is more than just providing excess returns, it's about providing better outcomes for clients.

Thomson: Is that connected to the trend toward exchange-traded products and passive investing, or do you think it's separate from that?

Davidow: In our view, indexing has evolved a great deal over the past couple of years from cheap beta to smart beta. The first generation of indexing was designed to provide cost-effective exposure to segments of the market—cheap beta. Recently, we've seen an acceleration of new strategies designed to provide a better-than-market experience—smart beta. Many of these strategies leverage a lot of the academic research, identifying factors that have been persistent over time. These strategies are now available to individual investors in the form of exchange-traded funds (ETFs).

Initially, many advisors felt threatened by ETFs because they defined their value proposition as finding managers or mutual funds to outperform the market. The data has shown how difficult it is for managers to consistently outperform the market. We believe in the value of incorporating both active and passive strategies. Advisors now have more and better tools at their disposal, and rather than looking at ETFs as threats to active management, ETFs provide a broader and more complete toolbox.

Going back to that paradigm shift, advisors now determine the best ways to get exposure to an underlying asset class, and they have the ability to select among traditional passive strategies (market-cap), smart beta strategies, active management, or liquid alternatives. They have a much better ability now to build appropriate portfolios for each one of their clients.

Thomson: Scott, have you seen some of those same trends?

Welch: Absolutely. When you look at our industry, I like to refer to it as a "race to zero." You see significant fee compression coming in at the asset management level, and you see it coming in, maybe a little more slowly, but inevitably, at the advisor level. Advisors are forced to think about how they want to differentiate themselves and actually continue to be able to charge a premium price in this increasingly commoditized world.

The challenge I give to advisors when I speak publicly is, if they haven't opened up a personal account with one of the digital advice platforms, they need to. Even if it's just a couple hundred bucks, they need to understand the user experience, they need to understand the elegance of the technology and the ease with which you can get a portfolio implemented at a very low price. I did that exercise a couple years ago and was recommended a globally diversified portfolio of ETFs that I could invest in for 20 basis points.

If an advisor is charging 1 percent, the advisor better be prepared for when a client walks into the office, hands over that ETF portfolio, and asks, "Why am I paying you 80 basis points more?" And the answer is not because the advisor consistently delivers 80 basis points of investment outperformance year after year versus that passive portfolio. It's got to be something else.

I refer to it is as "focusing on the left side of the decimal point," that is, on the aspects of wealth management that can add handles of value, not just basis points. It's estate planning and tax planning and helping clients meet objectives and goals. All those things add way more long-term value than investment management can. And I say that as a chief investment officer.

Davidow: I would like to pick up on that thought. I agree with Scott, and these are topics that we've talked about quite a bit in the past. When Schwab rolled out our own automated advice offering to registered investment advisors (RIAs), some advisors initially felt threatened—but as they began to use the platform they realized it is simply a way to provide more scale and efficiency into their businesses. It's not an either-or proposition. I'm certainly a believer that advice—valuable advice—never will be commoditized, but if certain things can be automated, that's a good thing, not a bad thing.

Thomson: Scott, I want to pick up on a point you made that I find very interesting, when you talked about the fee compression in the industry. I've spoken a number of times about the massive fee compression that a client has seen and benefited from where, if you go back 20–30 years ago, they were paying 250–300 basis points for load mutual funds as well as other expensive ways of investing their money, and the advisor was typically getting about 100 basis points. If you fast forward to today, perhaps the advisor still gets 100 basis points but, instead of paying for load mutual funds with high expense ratios, the investor is now invested in ETFs at a 5–10 basis-point expense ratio, or perhaps in separately managed accounts at 25–50 basis points. So, yes, there has been huge fee compression, but it's all come from the asset management side. I think the market is actually speaking very clearly and saying that it sees the value in the advisor and less differentiated value on the investment management side.

Welch: I think there are a couple of different points to that. One is returns were higher 10, 15 years ago, right? So when the market is generating 10–12 percent, paying a couple hundred basis points of fees is one thing, but when the market is delivering 6–8 percent, there is just a natural compression factor there that needs to be dealt with.

We were taught academically that alpha is excess performance from active management, and that's certainly legitimate. No one would argue with that definition. But it's also hard to deliver and it's really hard to deliver consistently as an asset manager or as an advisor trying to pick managers.

I like to use what I refer to as a practitioner's definition of alpha, which I define as anything an advisor does in a client's portfolio that the client finds valuable and is willing to pay you for. If you accept that "multi-alpha" definition, it gives you some very different areas to explore in terms of adding value to a portfolio. I'm not thinking at all about the non-investment stuff, this is just the portfolio itself.

For example, if you can control fees and taxes (and those are the two things an advisor has the most control over), that's a definite source of alpha, that's real money in the client's pocket, and that's something the client should be willing to pay you for.

Other examples are the asset allocation and beta management decisions. We generally accept that the asset allocation decision is the most important decision you can make in the client's portfolio, but with the advent of equity long-short mutual funds, for example, you now have very usable beta management tools that allow you to dial up and down a client's beta exposure, and that's a clear potential source of value that a client should be willing to pay you for.

Still another example is what I refer to as a "smooth ride alpha." By deploying diversifying or lower-correlated strategies such as commodity trading advisors, real assets, and things like that, you can help deliver a more consistent performance and let the power of compounding work over time. That should be a legitimate source of value that clients should be willing to pay you for.

One last example is what I refer to as "leverage and illiquidity alpha," which basically means the intelligent use of hedge funds and private investments. Again, if you can do that smartly for your client, that's a legitimate source of additional value and your client should be willing to pay you for that.

The main point I'm trying to make is that you should discuss portfolio construction with your clients in *why* versus *what* terms. Don't just tell your clients what is in the portfolio, explain to them why it is there.

Thomson: Very good points, and I'd add another one, which is keeping clients from buying high and selling low, which can deliver several hundred basis points of alpha. What I've seen is somewhere between 200 and 400 basis points of advisor alpha from those things that Scott just talked about. Does that make sense Tony? Is that what you're seeing as well?

Davidow: It goes to my earlier point that, in the early days, we spent a lot of time trying to identify managers who could generate alpha, but when you look at any number of studies you see how fleeting it is that managers consistently outperform. At the Schwab Center for Financial Research, we have evaluated how few managers can consistently outperform the market. The top-performing manager in one time period is often a laggard in the next.

From an asset allocation perspective, we believe there is value in developing the right long-term strategic allocation per investor. We can then add value through portfolio construction, incorporating active and passive strategies. We also believe in the value of being a little bit more nimble or tactical—not 100 percent in or out of the market—but making subtle shifts on the margin can add value over time.

For portfolio construction, we developed a framework for allocation among active, market-cap, and fundamental index strategies (a form of smart beta). We begin by defining the role that each should play in the portfolio:

- Active: Active managers are uniquely qualified to deal with a behavioral issue—loss aversion. We suggest identifying managers who can play defense.
- Market-cap: Provides cost-effective exposure to the various segments of the market with little or no tracking error.
- Fundamental: Based on our research, fundamental index strategies have been able to generate excess returns across the major equity indexes.

The combination provides diversification, cost-effective exposure, and the potential for alpha. Our research shows they are better together.

The value of the advisor now is determining which are the most appropriate among all the solutions that you now have at your disposal. I think Scott did a great job discussing fees, taxes, being tactical to an extent, looking at illiquid strategies, getting an illiquidity premium in your portfolio, and so forth. That's really where the value is as opposed to spending all your time and energy to find a manager that's always outperformed—until you hire them.

Many smart advisors, the ones who actually are offering a differentiated experience, increasingly talk to their clients, present their portfolios, manage their portfolios, and report on their portfolios in ways that illustrate how they're helping clients meet their goals, and not necessarily focusing on whether or not their micro-cap manager beat its benchmark.

Welch: If I could add just one point on that. I think there's another interesting component, and that's somewhat of a mentality shift in the investor base. It's certainly true among younger investors, but increasingly true among older investors as well. Tony and I, and you as well Todd, were trained to be benchmark-relative investors and, if we could put together a portfolio that beat some specified benchmark, then we were doing a good job. But if you think about it from a client's perspective, benchmarks are completely irrelevant to them. It doesn't matter to them whether or not they beat the S&P 500 or the MSCI ACWI or whatever it may be. What matters to them is whether or not the portfolio you designed for them is helping them to meet their goals and objectives. Maybe that's partly being driven by a low-return environment, or rather an environment where passive strategies are consistently beating advisor-chosen active ones. Many smart advisors, the ones who actually are offering a differentiated experience, increasingly talk to their clients, present their portfolios, manage their portfolios, and report on their portfolios in ways that illustrate how they're helping clients meet their goals, and not necessarily focusing on whether or not their micro-cap manager beat its benchmark. I think that's really smart. I think that needs to be the way that advisors run their practices.

Thomson: Are you saying benchmark-relative performance doesn't have any impact on whether they can pay for their college education for their kids or their wedding or retirement?

Welch: Or whatever cause they believe in or philanthropic endeavor they're trying to achieve. The money has purpose to them and what they want from you is, "Are you helping me to meet my purpose?"

Davidow: Scott, I would just add that I think you and others have done a terrific job reframing the discussion in the industry to focus on goals-based investing. I know you've written about it and I think it's where the industry needs to evolve to. However, advisors need to be consistent in anchoring their discussions around progress relative to clients' goals. It can't be that you emphasize the progress relative to goals when it is convenient, and then emphasize the strong performance when the portfolio is outperforming.

We sometimes joke that clients have three benchmarks they typically look at—the S&P 500, cash, and their best friend's portfolio. When the markets are soaring, investors will lament that they didn't outperform the S&P 500. When the markets decline, they'll often complain that they would have done better sitting on cash. Unfortunately, they'll often hear from their buddies about their "hot" manager and wonder why they don't own the fund. Obviously, these may not be relevant benchmarks for clients.

The reality is if we can reorient our clients, and retrain them to focus on their goals, they're going to have much better outcomes. We need to be consistent in this approach in good times and bad.

Thomson: That's exactly right. Let me drill down a little bit on a couple of these elements. Let's start with tax alpha, because I think that's a really important one. I want to talk about the communication of this a little later as well. But tax alpha is relatively easier to communicate to clients than some other things that we've been talking about. Scott, tell us a little bit about how you achieve some tax alpha.

Welch: I think that there's a hierarchy or approach that you can use to build a tax-aware portfolio, what my friend Doug Rogers referred to as the "holy trinity" of tax-aware investing. It starts with asset location, which is putting tax-efficient investments into taxable accounts and tax-inefficient investments into tax-deferred accounts or qualified accounts or whatever it may be. You can add tremendous value just by optimizing where you put the investments inside the clients' overall portfolios. So, number one is asset location.

Number two is what I'll refer to as portfolio implementation, or the decisions you make between kinds of investment platforms or vehicles or strategies. For example, the unified managed account (UMA), which is multiple strategies inside a single account, to which you can then apply a tax management overlay. You can add dozens to hundreds of basis points per annum of tax alpha by running your diversified portfolio inside a UMA with tax overlay.

There are also things like insurance-dedicated funds and private placement variable life strategies. There are lots of these ideas and strategies that you can put your portfolio inside of at the implementation level that help to manage taxes.

Finally, the third is the investment products themselves. You look at things like ETFs or index funds or tax-managed index funds, of which I am a huge advocate. You can deploy your investment decisions with very tax-aware products and, if you combine those three things—asset location, portfolio implementation, and investment products—all of a sudden you've built the portfolio you want from an investment perspective but you have really given yourself the most opportunity to run a tax-aware or tax-sensitive portfolio.

Remember that you want to get away from that performance paradigm and really focus on helping clients fulfill their dreams, goals, and aspirations.

Thomson: I've seen numbers everywhere from 100 to 300 basis points of tax alpha that can be provided, so when you think about that as an advisor speaking to a client, basically the client is getting a great deal. He or she is paying the advisor 75 to 125 basis points and getting a return on that of 150 to 200 basis points in tax alpha. In essence the client is getting all the other services the advisors provide for free. That is a remarkable deal when you think about it.

Welch: I want to get Tony's input on this as well, but it's unfortunate that we still live in a pre-tax world, so most investors continue to focus on pre-tax returns because that's the number that they are given by their asset managers.

Davidow: I agree that people don't talk enough about tax alpha. Taxes become a much bigger issue in a low-return environment. Taxes really do affect the "take home" return, and I agree with Scott on the asset location aspect. Certainly part of the appeal of ETFs is that they are tax efficient. Some of these automated solutions provide tax-loss harvesting as well. As an industry, I think we need to do a better job talking about the after-tax returns. I suspect a lot of the better advisors spend time on the tax management side even if it's sometimes difficult to quantify for clients.

Welch: You have the ability to pay for yourself as an advisor.

Thomson: Tony, how do you talk about this with clients? How do you talk to clients about advisor alpha in an intelligent way? Do you have some examples of how it works effectively? The communication aspect of this often seems a little bit complicated and difficult. What's the right way to do this?

Davidow: I'm not sure there's one perfect way to discuss this with clients. I do believe that it begins with how an advisor articulates his or her value proposition. Clients need to know in advance where and how you plan to add alpha over time throughout the relationship.

Remember that you want to get away from that performance paradigm and really focus on helping clients fulfill their dreams, goals, and aspirations. I think it is helpful to list all of the things that you do including: developing a financial or investment plan, trust and estate planning, developing an asset allocation, portfolio construction, incorporating tactical shifts, tax management, etc. I think it's important to remind and reinforce to your client how you are adding value above and beyond performance alpha.

Another challenge for us is to refrain from using a lot of industry jargon that clients don't understand—alpha, beta, Sharpe ratio, correlation, etc. I think we have to reframe the discussion in terms that clients understand. What are we doing? Why are we doing it? How do we measure success?

We need to help them anticipate that markets don't always go up, and our job is to keep them engaged when it feels the most uncomfortable. We need to make sure that we establish realistic goals, and we need to report to them on a regular basis. We need to periodically revisit client goals and objectives to make sure that things haven't changed over time.

When you are making progress relative to your goal, we should celebrate that and remind them that's why we established the agreed-upon path at the beginning. Again, it is the articulation of the value proposition in the beginning and the constant reinforcement along the way. I really want to emphasize that we need to try and put it in terms that clients understand rather than the jargon that we all fall prey to.

Thomson: Scott, you've been doing this with advisors and in a lot of cases directly with their clients for a long time. Any insights from you on this?

Welch: There's some good news on this topic. I think of the wealth management business as having descended from the institutional consulting business, and that led us into some traps. At the institutional level benchmark-relative performance does matter, but taxes don't really matter. You're dealing with a board or a group of people who are making the decisions, not individuals who frequently change their minds. Yet, if you think about a typical performance report, what you're doing is explicitly linking your only value prop to the numbers on that page. How did my portfolio do? And there's no recognition of the other—often times more important—value that you are adding.

An example I use is that after 2008 when the markets collapsed, an advisor's assets under management (AUM) dropped by 20, 30, 40 percent just due to market decline. Because they typically charged on a percent of AUM, their fees also dropped by 20, 30, 40 percent. Yet I would argue that that was a period of time when they were actually adding the most value to clients because they were holding their hands, they were stopping them from panicking, they were creating strategies to help them get out from under their fear.

The good news on that side of the story, though, is that I think the technology has advanced and continues to advance so that we now actually have improved abilities to convey those non-performance-related values to our clients. I have seen performance reports, for example, that have a "progress to plan" graphic, which simply means illustrating what was agreed to between advisor and client, and how they're doing. Do they need to make any changes?

At the end of the day that's the only number the client needs, right? How am I doing? I've seen more sophisticated advisors rethink how they do their quarterly reviews with clients to bring the attention away from just the investment performance and toward the planning value that they've been adding all along and over time.

Davidow: Let's talk a little about behavioral finance. The 2008 market was such a great reminder of why it matters. A lot of the value of an advisor is the ability to keep clients engaged when it feels the most uncomfortable. We frequently need to protect clients from themselves because left to their own devices they'll often make the wrong decision at the wrong time. It's not their fault—it's the way we are wired as human beings. I recall in January 2016 doing client events and hearing: "I'm panicked. I'm ready to get out of the market." The ability to keep our clients engaged in those difficult times is one of the biggest value-adds that we provide because we know that if they get out of the market, they likely won't get back in at the right time.

In fact, if we look at industry flow data across the board, there's something of the magnitude of $2 trillion sitting in cash. That means clients missed out on the bull market run-up since March 2009, and that's scary. How are they possibly going to be able to meet their dreams, goals, and aspirations? How are they going to retire sitting on cash when they're getting a negative real return? The value of an advisor is the most important when things get the most uncomfortable.

Welch: I think you put your finger on something really important there Tony, which is recognizing that our clients don't speak our language. You and I can talk about alpha and portfolio construction and alternative investments and volatility and standard deviation and all that stuff all day long. Our clients, that's not their language. Look at a typical investment proposal. What do you show your client? You show them expected return, you show them standard deviation, upside capture, downside capture, batting averages, information ratios, and all that means nothing to your client, right? I think it's really important to recognize that as an advisor. What your clients want to know is that you understand what they're trying to do, you've put a portfolio together that you believe gives them the best opportunity to meet those goals, and you're going to be by their side the entire journey to make sure that they get to where they want to go.

Thomson: I think that's exactly right, but back to my communication question, how do you communicate this "behavioral alpha" when really what you're saying is, "Mr. Client I'm keeping you from being stupid?"

Welch: I think that's why at the beginning of the relationship you have a discovery process with your client and you document it, however you two choose to do that. Then on every occasion that merits it you bring out that document and say, "Hey, remember this is what we agreed to, this is why I still believe this is an appropriate way to get where you want to go and oh, by the way, if I ever feel along the way that we should change this, then we will have that conversation." So you're not telling them they're stupid, you're just reminding them of what they agreed to when you started.

Davidow: I also think that part of it is that the successful advisor is a part-time psychologist. The really good advisor is going to be able to pick up the verbal and non-verbal cues the client is sending—understanding and interpreting the behavioral biases that everyone brings to the table. There's a lot of academic literature on these behavioral biases.

For example, loss aversion is one of the things we all read about and talk about a lot. If I start to have a discussion with a client, I may want to tease out how they feel about losses in their portfolio by personalizing a little bit, "How did you feel in 2008?" We should try and gauge how the client really feels about losses. It can help in the way you build portfolios. I want to have discussions with them about losses and the pain that they feel over time. If I know that a client gets overwhelmed by too much information I want to make sure I provide simple solutions, I want to lead them to a solution as opposed to having them make it on their own.

So I think to some extent we've got to be able to better analyze our clients to understand how they're going to react to things and how they're going to consume information. If we do a good job at the beginning in understanding our clients' behavioral biases, then we can reinforce our approach over time to make sure that we're talking to them in terms that they understand.

Welch: If I could add on to that, Todd, this whole concept of goals-based investing is built on the exact foundation that Tony just talked about. The example I use, and I'm borrowing from my friend and industry thought-leader Ashvin Chhabra here, is the concept of a wealth allocation framework.

Say your client has $10 million and they've told you that they don't ever want to be worth less than $5 million. Okay, let's take that $5 million and put it into capital preservation strategies. We're not looking for a lot of upside. I'm not necessarily trying to optimize that portfolio. I'm trying to make sure that capital is preserved and is safe and it grows with inflation. Then maybe they're willing to take $3 million and put it into the market because that's what everybody does and they want to be able to talk about it at cocktail parties or on the golf course. That's the world that we grew up in and that's the world we're used to. That portfolio looks very familiar and comfortable to us, and we might use very familiar optimization approaches for that part of the portfolio.

Then, with the remaining $2 million, perhaps they say, "Hey, I wouldn't mind being worth $20 million, let's take a flier with this $2 million and put it into something aspirational and, yes, I understand I can lose it all."

If you think about these "buckets" from an academic optimization perspective, there is no optimization methodology that fits the first and third buckets—no optimization where losing none or all of your money is an optimizable outcome.

So if half of this client's portfolio falls into one of those categories, where they could lose it all or they can't lose any of it, trying to apply traditional optimization techniques doesn't work, it's silly.

Thomson: It makes a lot of sense. Everything you both just went through makes so much sense and it resonates with what clients seem to care about. But when you look at our industry, it seems to me that still there's a large percentage of advisors out there who aren't speaking this kind of language, they're still talking about investment performance. They're still talking about performance alpha. They're still comparing to benchmarks. Why is that, do you think? Is it just a matter of education in time or is there something else going on?

Welch: I think part of it is that a lot of people are drawn to this industry because they like investing. Their personal interest and passion revolves around investments and investing, and they view or define themselves primarily as a portfolio manager or as an investor. There's nothing wrong with that except if you're a registered investment advisor and you actually are trying to grow your business, you're not going to be able to do it. At some point, if you're trying to be the business owner, the business development officer, and the portfolio manager, you will cap yourself in terms of your potential growth.

It's uncomfortable for some people to realize, but at the end of the day, this is a business. It happens to be a wealth management business. But it's a business like any other business. It's like running a taco shop. If you want to grow, you have to make good business decisions. So part of this is just having that conversation with advisors and saying, "You should be focusing on the things that you do absolutely the best and you should be outsourcing for the other things that can help you grow your business scalably and profitably. If you like being portfolio manager that's fine, but then you need to surround yourself with people or resources who can do the other things that are necessary to actually grow the practice.

Davidow: I'll just go back to my background with a major investment banking firm, where the mindset was taking that institutional process and applying it to growing your business. Unfortunately, there are a lot of differences between institutions and individuals in the way that they think and make decisions. It may seem daunting to change the language and to change the way that you think about your value proposition, but that is in fact where opportunity lies. Those who are quicker to respond to the changing environment will likely reap the benefits in the form of more satisfied clients.

Todd, you're exactly right that since everyone hasn't embraced this different way of thinking and speaking about your business, the opportunity for advisors is to start to embrace it, to start to speak in terms that clients understand, to start to speak in a goals-based format that actually provides a higher likelihood of clients achieving their goals over the long run. That's an opportunity to grow your business, that's an opportunity to take market share, and that's an opportunity to relate to clients in a way that maybe some of the other firms across the industry are slow to grasp.

Thomson: I'm going to turn to you both for some final comments but, as you do that I'd also like you to give us your thoughts on why is it that the industry, given the importance of all the things we've discussed, still hasn't adjusted, not only on communication but also fees.

If you think about most of the industry, we tend to charge our clients basis points on assets. That may be very legitimate, it may be the right way to pay for our services, yet it's really not reflective of the value we're adding. So include that topic in your comments. Tony, I want to turn to you first.

Davidow: Scott and I are somewhat fortunate, not only in our day jobs, but also in being involved in various industry groups. This has been a topic for Investments & Wealth Institute conferences and the *Investments & Wealth Monitor* editorial advisory board for the past couple of years. The industry is changing dramatically, and we need to help advisors to evolve their practices and competencies. If you look at the industry demographics, we're all of similar age. We all look a certain way and need more diversity across the industry.

Those who will be successful will embrace this new paradigm shift in a positive way, they'll change the way they communicate with clients, they'll change the way that they engage with clients.

I understand it can be difficult to change what you've done over time, especially if you've been successful. I think that's human nature. I think all of us need to look in the mirror, look at the world around us, and look at how rapidly the world around us has changed.

> *"What does my business model look like? How do I price it? How do I scale it?"*

What is our business going to look like five years from now, 10 years from now? The successful advisor's going to look at it and say: "I'm going to change because I know I can't afford to do what I've done in the past. I'm going to seize the opportunity and beat my competitors by evolving to where the puck is going to be." Successful advisors will reshape their value proposition. They'll think about how they can grow their business in an intelligent way. They'll consider adding younger partners who can help them grow their practices.

Then, all of a sudden, they start to think: "What does my business model look like? How do I price it? How do I scale it?" I understand it's an uncomfortable thing, but it's something worth carefully considering. Those advisors who embrace change will be best-positioned for future growth.

Welch: I think part of it is inertia. I think that we have spent, as an industry, 30 years teaching our clients to be treated in a certain way and communicated with in a certain way. That way reflects the institutional consulting model, where we talk about asset allocation and portfolio construction and standard deviation and modern portfolio theory, and so forth.

As an industry we've trained our clients to expect that kind of behavior from us and so part of this is just going to be an educational process, because one of the things that we all know is true is no one is going to try to sell something that they're not comfortable with themselves.

Another reason the industry has been slow to evolve is that the technology just hasn't been there to run a practice scalably in the ways we've been discussing.

The technology has advanced to a point where now you can, and it's only going to get better, so I think you'll see an evolution being driven by the expectations of the clients themselves, who don't want to talk about benchmark-relative performance, they want to talk about how well you are doing in helping them to meet their goals. That's the lens through which they're going to evaluate you, and once that happens advisors have to adapt, they have to change the way they present things, they have to change the way they communicate, they have to change the way they manage their client portfolios.

You mentioned pricing, and it's unfortunate that we're out of time because that's a whole different conversation. Basis points on AUM is a fundamentally flawed pricing model and yet it's the model that most of us use, which is unfortunate.

Thomson: Scott Welch, Dynasty Chief Investment Officer. Tony Davidow from the Schwab Center for Financial Research. Thank you so much for joining "D:Talks" today. This is Todd Thomson and we look forward to talking to you next time.

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