WM Today: Focus on Wealth Management

This Issue: Excerpts from the Money Management Institute's Spring Convention in Boston, MA

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ABOUT EZRA GROUP
Launched by Craig Iskowitz in 2005, Ezra Group is a consulting firm providing software development services, business and technology strategy and operational expertise. Our focus is in the financial services industry, adding value in wealth management, asset management, retail brokerage, private banking, equity research and hedge funds.

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Opening Keynote Speaker

LPL Strives to Improve RIA Practice Efficiency

In 2010, LPL Financial grew the AUM on its hybrid RIA platform from $7.3 billion to $13.5 billion, an 85% jump. One of the main drivers that is attracting independent brokers is LPL's ability to improve practice efficiency.

This point was highlighted by the keynote speaker of the MMI 2011 Convention, Mark Casady, Chairman & CEO, LPL Financial. Mark described the results of a study they commissioned by PriceWaterhouseCoopers that found RIA practices at LPL to be 20% more efficient than other platforms. The study also reported that LPL practices generate 80% more revenue per client.

Advisor efficiency is important metric at LPL. The average advisor can support around 300 households, Mark reported. The industry will need to use a combination of technology and best practices to increase this to 400-600 households ten years from now.

One way that LPL has enabled advisors to handle more accounts is via their All ETF Program in conjunction with BlackRock. This program added $1 billion in AUM in its first eight months, Mark reported, and it also increases the practice efficiency by "outsourcing" the investment selection and allowing the advisor to focus on relationship management.

LPL also focuses on practice management, Mark noted, by helping advisors to better support their business today and improve profitability. For example, when they analyzed pricing across their client base and adjusted for practice size and region, they found that most of their advisors were underpriced! They developed "suggested retail pricing" in different parts of the country.

Special General Session

How Great Leaders Inspire Everyone to Take Action

The speaker was Simon Sinek, Renowned Leadership Expert and author of Start With Why.

"There are 'leaders' and 'those who lead',"asserted Simon. Most companies have no clue why their customers are their customers. They only think they know.

Simon explained that there are two ways to change human behavior -- through manipulation or through inspiration.

Manipulation

There are numerous ways that companies try to manipulate people to buy, Simon proposed. The biggest one is fear, but others are price cuts, aspirational messages and peer pressure. A company might claim that '70% of the industry is using our service'. But what about the other 30%? Maybe they know something that we don't?

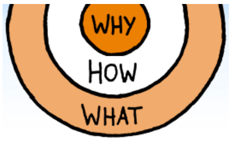
There's a huge difference between innovation and novelty, Simon argued. Real innovation changes the course of industries, if not society itself. Take the fax machine versus the camera phone. The first is innovative and changed the way we communicate. The other is just a feature added to an existing product. It's novelty. "Novelty isn't innovation," Simon reminded us, emphatically.

Innovation is often less, not more, since less is more powerful than more (see Apple's minimalist line of products).

Adding features doesn't breed loyalty, so how do we stand out in a crowded marketplace? The alternative is inspiration.

Inspiration

Regardless of industry, great communicators think, act and communicate the exact same way, which is the complete opposite to everyone else. They have the most loyal companies and employees. What are they doing differently?



The Golden Circle

This looks just like a bullseye, with the words 'why', 'how' and 'what' inside. Innovative companies work from the inside out. They define 'why' they exist before anything else. All other companies do the opposite. They decide 'what' they will make or do and 'how' they will do it, but never get to the 'why', Simon commented.

By WHY, he means why does your organization exist? Why do you get out of bed every morning? And why should anyone care?

Innovative companies like Apple and SouthWest Airlines have clear, consistent values and are experts at communicating them. Many visionaries aren't leaders because they lack the ability to communicate effectively.

Apple's employees love it there because they're given a reason to come to work -- they find an industry where the status quo has always been accepted and they destroy it.

What is a company? Simon's definition is, "it's a group of people with a common set of values and beliefs". People respond to the unfamiliar by seeking out other people that share their values and beliefs. An owner of an Apple computer can instantly connect with another Apple computer owner. The computer they purchased becomes a symbol and defines who they are. Anyone else that displays the same symbol most likely shares their values and beliefs. It's human nature to seek out symbols to feel like we belong.

The difference is between buying a product or service because you 'like' the company versus buying it because you 'love' the company. People 'like' Dell, but they 'love' Apple. Love is an emotion and drives behavior. It's irrational. Like is a feeling and is quite rational. Getting people to love your company is the difference between repeat business and customer loyalty.◆

For more information on Simon go to www.startwithwhy.com

The Impact of Discretion on Advisory Solutions Business Models

The moderator for this session was Anthony Rochte, Senior Managing Director, Head of North American Intermediary Business Group, State Street Global Advisors. The panelists were Hans Asoera, Principal, Financial Advisor, Edward Jones, Stephen J. Cucchiaro, Founder and Chief Investment Officer, Windhaven Investment Management and Mary B. Mullin, Managing Director - Investments, Merrill Lynch Wealth Management

Anthony started off by quoting from an investor survey done by IBM that asked one simple question, 'Would you recommend your financial advisor to someone else?' Only 13% would recommend, 50% would not, while 33% didn't even care!

According to research done by Windhaven Investments, most markets are macro-efficient and micro-inefficient, Stephen reported. There's so much competition in trading individual companies, that they decided to invest at the asset class level. Windhaven focuses on the world's top 20 asset classes, all in ETF index form. All markets are never in equilibrium, they're always in a state of flux, Stephen noted.

> Only 13% of investors would recommend their advisor to someone else. 50% said they wouldn't and 33% said they didn't even care.
>
> -- IBM Investor Survey

Edward Jones uses a metric called "client service excellence," Hans explained. Analysis of the results identified three specific movers that improve client satisfaction: 1) Frequency of contact, 2) Clear understanding of fees, 3) The number of transactions.

Advisory accounts have an advantage over brokerage accounts when comparing scores in client service excellence because 1) more time is available for contacting clients since investment management is outsourced; 2) explaining fees is easy since asset classes don't have different compensations rates; 3) there are no commissions on transactions.

Can you build an endowment model for a retail investor?

The head of our advisory board "invented" the endowment model when he was at Harvard Management, Stephen responded, and he would be the first to say that it isn't appropriate for every client. The main problem is liquidity, since endowments often invest in illiquid securities. This became a problem during the downturn in 2007.

What is behind Windhaven's success in the past five months?

Windhaven had about a 60% annual growth rate from 2002 when they had $70mm in assets to 2011 when they have $6 billion, Stephen noted. A lot of this is due to their team and relationships to advisors and brokers, he said.

Clients today are more aware of risk. Model portfolio theory, which was invented in the 1960's, doesn't get to where the real risk lies. Windhaven's ability to control risk has helped them generate trust with clients.

"I don't have to hit a home run, the occasional double or triple is fine, I just don't want to strike out," Stephen joked.

Does your firm use alternative investments?

Merrill Lynch's research recommends allocations to alternatives at all risk levels and all liquidity levels, Mary commented. However, their lack of transparency, lack of liquidity, and tax reporting issues make them difficult to manage and their fees often can't be justified. They've tried to find AI proxies with mutual funds. While they're not perfect, they can be used to replicate the space. "We pretty much avoid traditional AI in order to stay liquid," Mary said.

Some of Windhaven's growth comes from investors looking for alternative returns. "We've been called "the alternative to alternatives," Stephen claimed. ◆

Impact Investing

A New Frontier in Advisory Solutions

The moderator was Thomas Kostigen, Editorial Contributor, Dow Jones Market Watch and the panelists were Stuart J. Boesky, CEO, The Pembrook Group, John M. Buley, Jr., Managing Director, J.P. Morgan and Sean Greene, Associate Administrator for Investment, U.S. Small Business Administration (SBA).

The goals of Impact Investing, which is also referred to as Socially Responsible Investing (SRI), are to provide above average returns for investors while simultaneously meeting political or social needs. The market size for SRI is approximately $50 billion with a ten-fold increase projected over the next ten years, Thomas reported.

The Pembrook Group has levered off government programs to provide their investors an above-market, risk-adjusted return, according to Stuart. They felt that if they could master the utilization of government programs to support the flow of capital for certain political and policy reasons, there would be an advantage in producing returns for their investors.

They have a Private Equity product that produces a high, current return by taking advantage of the lack of capital in the commercial real estate market and using first mortgages, bridge and mezzanine loans. What makes this a better investment is that Pembrook figured out how to leverage government programs that require U.S. banks to invest in urban areas or areas that have been designated for redevelopment.

Pembrook is also working on a tax-exempt program using the Community Re-Investment Act. These investments receive an exemption from federal income taxes, which translates into a 35% increase in net return (at the highest taxable federal rate). This is the only asset class where the owner of a mortgage can get term financing, with no mark to market issues, and the net result is that returns on these bonds is approximately 17%.

The JP Morgan Social Finance Group was started in 2007, John noted. Their definition of impact investing is where the intent of the investor is to seek not only a financial return but to also an extra return in the form of a social or economic impact. JP Morgan provided a $100 mm in 2008 for impact investments predominantly in emerging markets. The focus on the poor and underserved throughout the world. Most of the investments that they have made have gone to the "base" of the economic pyramid. John reminded us that 70% of the world population lives under circumstances where they have no access to capital, clean water or formal education. Micro-finance is one of the tools by which skilled people are bringing capital solutions to poverty remediation. They're missing a system which brings capital to entrepreneurs, where they can build small and medium sized enterprises.

They're not part of the JP Morgan foundation, they're part of the investment bank, but their motives are not pure profit maximization. In fact, their definition of impact investment relies on the strict measurement of outcomes, John stressed. They ask questions such as, "What have you done that has a measurable impact in emerging market societies?" Return is important, but it's not the only measurement.

The government is also participating in the SRI trend. Sean revealed that the SBA is committed to deploying $1 billion of capital in impact investing over the next five years. Two-thirds of net new jobs come from small businesses, he said. More than 90% of those new jobs are concentrated in just 4-5% of small firms.

The Small Business Investment Company (SBIC) program that provides access to capital for small businesses. It is a fund of funds with $16 billion AUM, half private, half public. It has funded formerly small businesses such as Intel, Fedex and Costco. The fund costs taxpayers nothing because the government is paid back by profits, Sean explained.

The government funds the program with debt, which provides additional upside due to the low cost of its leverage. ◆

With Impact Investing, a Focus on More Than Returns

By Paul Sullivan, The New York Times, www.nytimes.com

The very phrase "impact investing" sounds rapacious, but it is an emerging hybrid of philanthropy and private equity that proponents say is about to become more widespread. It is also something that has some very rich people intrigued.

"It's filling the space in between this historical space around philanthropy — charitable giving to fight poverty and alleviate misery — and the traditional investing space that is return-driven," said Julia Sze, director of investments at Wells Fargo Family Wealth, who ran an impact investing conference in San Francisco.

More often, impact investing is described by what it is not. It does not work in the same way as socially responsible investing, which excludes areas a person does not want to invest in — like tobacco or guns — through a simple screening process. Impact investing focuses more on bringing about change — helping the working poor in India buy a home, for instance.

"I think we have to look at investment as a positive tool in advancing human goals," said Chris Redlich, who sold his family's company, the Marine Terminals Corporation, in 2007.

He has taken $10 million, or about 1 percent of his net worth, and started to invest it in a series of funds. One fund is run by Grassroots Capital and makes traditional microfinance investments. Another is a fund focused on affordable housing in India. A third concentrates on energy technology in China.

For Mr. Redlich, though, the goal is different. "I think investment improves the quality of life around the world," he said. "At the end of the day, I already have enough money. I'm not chasing yield to be wealthier. I'm chasing yield to improve society in a more capitalistic way."

Economics and Finance

Taking Advantage of the Global Economic Expansion and Recovery

The moderator for this session was Richard Hoey, Chief Economist, Bank of New York Mellon. The panelists were Michael Atkin, Head of Sovereign Credit Research, Putnam Investments, David R. Bailin, Managing Director and Global Head of Managed Investments, Citi Private Bank and George Iwanicki, Jr., Global Emerging Markets Macro Strategists, J.P. Morgan Asset Management.

Michael started off by explaining that he's concerned about short term market volatility, largely because the global economy has reached a significant inflection point. We've been in an environment where policy has been extremely accommodative almost everywhere. Interest rates have been kept low by central banks, accompanied by massive fiscal stimulus.

The US policy environment is changing at the same time that the recovery in the rest of the world is losing a little bit of it's dynamism, Michael continued. These sort of inflection points in the economy, where financial conditions are being tightened a little bit, where there's uncertainty over the shorter term trajectory of the economy, those are environments where you'd expect some volatility. "I think the short term environment is where we should expect some volatility and in most of our fixed income funds we've dialed down the risk somewhat," he said.

George reminded the audience that when the financial crisis occurred, emerging markets were furthest from the epicenter. Combined with their clean public and private balance sheets meant that emerging markets were both willing and able to provide stimulus to their economies. And more importantly, they got full response from their stimulus.

There are a handful of countries where the inflation pressures are beginning to embed and place cyclical risk on economies, George observed. The good news is that these are only a few economies, but the bad news is that it is some of the larger ones.

These are the larger economies that are at risk, according to George:

1) India - They have the highest risk. Inflation expectations have begun to "de-anchor" and now the central bank is starting the catch up process and becoming more aggressive. So, JPM is still cautious on India, in part because valuations are rich, but also since the inflation cycle hasn't been halted.

2) Indonesia - To some degree it falls into the same boat, where they had a booming recovery. The exchange rate has rallied in a way that has contained some of the inflation pressures.

3) Brazil - Their central bank did about half of a tightening cycle last year and it looks like they're finishing the job now. Inflation pressures look so far as to have been reasonably contained.

4) China - The slowdown is becoming more evident. They have been tightening the longest. They were the first out of the recession, the first into recovery, the first into the boom and the first to tighten. If you look at the import numbers that just came out, we're starting to see an accumulation of evidence that the economy is starting to respond to tightening by slowing down. Accordingly, the inflation pressures look as though they're poised to be reigned in.

> "I think the short term environment is where we should expect some volatility and in most of our fixed income funds we've dialed down the risk somewhat."
>
> -- Michael Atkin, Head of Sovereign Credit Research, Putnam Investments

Based on some of the dynamics that are unfolding in markets today, George's opinion is that the strong recoveries in the emerging world combined with dollar weakness have been a very powerful tonic for commodities.

Following up on George's comments on risk, regarding investors in general, David said, "risk is clearly back on." However, investor's views of asset allocation have changed, he cautioned. Their holdings of cash and liquid investments are permanently staying at significant levels. We're seeing a very different vantage point in terms of timing. When we look at closed to venture capital and private equity alternatives, we see them diminished. Investors have a shorter term views of their portfolios, many of them are seeking to get paid now in the form of dividends. You can see that in the way that fixed income spreads have come in. When we talk about volatility, one of the reasons why we believe that volatility is real, is that we believe that there is a bit of complacency due the markets having tolerated so much incredible news, he stated.

What is going to happen with the situation in Greece?

Germany should thank the Greeks and Spaniards for contributing to the weak Euro, since it has kept their exports cheap, Dick commented.

Michael responded by listing three key issues that will determine the timeline and what is likely to happen:

1) Everything is being driven by the timetable of German politics. Their leaders know that they are going to have to pay for all this. They want to pay as little as possible, as far into the future as possible. But they also want to exact a very high price in order to discourage other countries from behaving badly.

2) Greece is insolvent. Almost everybody knows this. People are very uncertain about Portugal, Spain and Ireland also being insolvent. However, solvency is endogenous to market conditions. The Europeans want to make it possible for these countries to show themselves to be solvent. That requires a certain trajectory of interest rates and also requires that they not be too explicit as to how insolvent Greece is because they're worried it could become contagious.

3) The EU banking system is over-exposed to peripheral countries. The EU has been very slow in responding. The banking system hasn't improved its balance sheet as dramatically as the US and UK have. We know that Greece has to restructure, but the EU wants to put it off as long as they can since doing it quicker will hurt the European banking system and will also increase the likelihood that Portgual and Ireland will also have to restructure. Then the problem will become too big to manage. ◆

Products and Platforms

UMAs: Current Challenges and Future Opportunities

The moderator for this session was Lee Chertavian, Chairman & CEO, Placemark Investments. The panelists were Marilee Ferone, Executive Director, UBS Financial Services, Roger Paradiso, President, Chief Investment Officer, Morgan Stanley Smith Barney and Russell W. Tipper, Director, Third Party Discretionary Programs, Managed Solutions Group Merrill Lynch.

According to Dover Research, UMA asset growth was over 100% last year, yet at $123 billion, it makes up only 6% of total managed account assets. 88% of sponsors report that UMA will receive the greatest amount of funding next year.

There was a lot of debate in the industry regarding overlay management program types between active, hybrid and passive, Lee commented. Back in 2007, sponsors were evenly distributed between the three, but by 2010, the vast majority (80%) had shifted to active overlay, using model portfolios.

There's been a tremendous change in manager's attitudes regarding model-based delivery. Among the top 25 model managers, over 40% weren't providing models just five years ago.

82% of respondents said that UMH was important, although the technology is still in its infancy.

UBS Strategic Wealth Portfolios

The UBS program is passive-only, with no models and no active overlay, Marilee informed us. It's non-discretionary, except for the sleeve that the money manager controls. It has $6 billion in AUM, with an average account size of $1.3 million.

UBS provides a lot of flexibility for advisors to select investments from an open architecture with over 200 SMA managers to choose from along with 3,100 mutual funds and 300 ETFs. Hedge funds were available when the program started a few years ago, but demand died off due to their limited liquidity. Asset growth in 2010 was nearly 60%, Marilee reported.

Merrill Lynch

Merrill Lynch launched their UMA in 2007, Russ noted. It now has $22 billion in AUM and 42,000 accounts (average account size = $523,000) and is entirely model-based. They allow managers to retain discretion depending on the market that they're trading in. Merrill sees UMA as a platform for delivering advice and leveraging their investment partners.

They offer a full spectrum and provide flexibility for advisors where they can implement a stand-alone SMA or a model containing mutual funds, equities and ETFs. Merrill's core offering is focused on SMA, ETFs and funds with 40% of the business in stand-alone SMA and the other 60% in models. In most cases, they leverage the firm models and don't allow swapping of strategies. Russ stressed that they want their platform to provide advisors choice and flexibility.

Morgan Stanley Smith Barney

We look at UMA as a solution-based platform, Roger stated. It's open architecture and designed around the way the advisor and client want to engage. The platform offers over 250 SMA products using model-based delivery, over 300 40 Act vehicles, and over 150 ETFs.

Advisors can create custom asset allocation structures and their own models, which they can use as completion strategies. There are also asset allocations driven by the Global Investment Committee, which created eight models for advisors to choose from. In addition, they can select either strategic or tactical allocations.

Roger listed three client engagement models that are available:

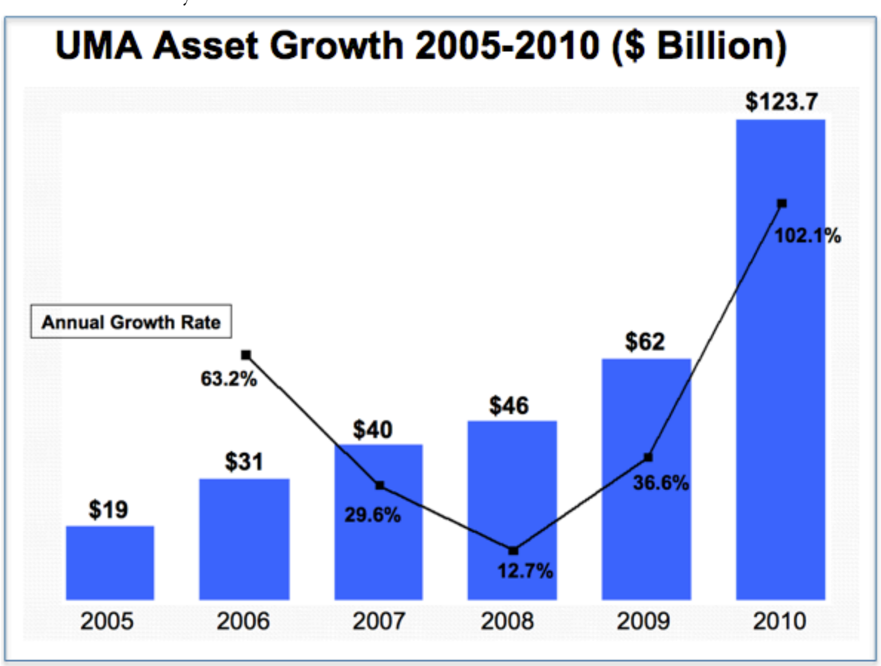
- Client Discretion (traditional)
- FA Discretion
- Consulting Group (CG) Discretion

The CG Discretion uses MSSB asset allocation models and handles manager selection ($25K minimums for all mutual fund/ETF version and $500K for hybrid version where the firm creates a custom investment selection)

The personal level of the program allows advisors to select from options

TOP 10 MODEL MANAGERS
(AUM IN $ MILLIONS)

1. Allianz Global Investors - $15,908
2. Neuberger Berman - $8,547
3. BlackRock Financial - $4,682
4. Natixis Global Associates - $4,517
5. Jennison Associates - $4,152
6. Eaton Vance - $4,152
7. MFS Investment - $3,709
8. Lord, Abbett & Co. - $3,335
9. J.P. Morgan Inv. Mgmt. - $3,205
10. Nuveen Investments - $2,693



Source: Money Management Institute

including tax-managed strategies, restrictions, and transitions.

The one constant, no matter what the engagement model, is the Private Portfolio Group acts as the overlay portfolio manager. A key aspect is the proprietary technology that they've built over the past 15 years. There are over 250 people on the team with an average experience of 12 years.

What fixed income options do your programs offer? Do you support muni bond laddering?

The UBS program does not support direct purchase of bonds. They provide the ability for FAs to choose a fixed income allocation that is fulfilled using ETFs or mutual funds. FAs have asked for muni bond laddering, Marilee said, but they haven't built it out yet.

Merrill advisors have access to top industry fixed income talent, according to Russ. On the taxable side, their overlay manager does the full implementation and in the municipal space, they give managers discretion. Their FA's have asked for muni bond ladders, but there are issues such as determining the proper minimum account size and the amount of alpha that muni managers can bring.

MSSB offers a dual-discretion model, where they oversee everything, but the fixed income managers do their own trading.

What changes did your firm make to your front-end to add financial planning to your UMA platform?

Merrill has a front-end financial planning engine that's fully integrated into their advisor desktops, Russ pointed out. However, it doesn't have the ability to go from idea to execution. In other words, it doesn't connect to the portfolio construction or UMA implementation process. Their next generation UMA platform will integrate financial planning into so it will be an end-to-end process.

Roger confirmed that MSSB is in the same boat. They need to make the connection between the financial plan and implementation. They should follow through with the plan over the client's lifetime, but it's extremely challenging.

How have you changed performance reporting to better support UMA?

UBS provides all standard performance reports, including monthly and quarterly that go down to the sleeve level including attribution analysis.

Merrill leverages a single platform across their entire business, so clients receive a similar report whether they're in an FA-directed, client-directed or discretionary account. They've made enhancements to the platform to show sleeve level performance and attribution and historical changes over time. ◆

JPMorgan Doubles Model SMA, UMA Biz in '10

By Tom Stabile, www.fundfire.com

JPMorgan's asset management and Chase wealth management arms both enjoyed boosted assets in 2010 thanks to a strong year for unified managed account programs across the industry. Its asset management business saw model portfolio-driven separately managed accounts double to $3.2 billion, while its Chase Investment Services unified managed account program flew from $5.2 billion at the start of 2010 to $13.7 billion at the end of the fourth quarter.

The Chase brokerage arm does appear to have an edge helping it outpace many competitors, says **Craig Iskowitz**, managing director of Ezra Group, a consultancy. One of those is being able to tap its asset management affiliate.

Another strength appears to be how Chase's UMA already has a format many competitors are trying to establish – fully discretionary client relationships, which means advisors don't have to check back with clients on every investment move, and a model that keeps most portfolio decision-making at the home office.

"It's way more efficient to have it done in the home office," Iskowitz says. "And if you have a good [investment] mix, it can be powerful because studies have shown that asset allocation is 80% of your return." He says adding in a solid technology platform with robust rebalancing capabilities can increase efficiencies for a brokerage operation.