Financial coach or personalized portfolio builder – why not both?

With the right tech platform, your firm's advisors should not have to choose

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Introduction

Financial advisors and their investment management teams are pressured to increase their range of services and step more into the dual role of financial coach and builder of personalized portfolios. As such, firms are rethinking their business models and operational priorities to meet both needs in an especially volatile market environment. The S&P 500 has lost 25% of its value this year, but could still fall by "another easy 20%," JPMorgan Chase CEO Jamie Dimon recently predicted.[1] Such outlooks are leading to panicky investors and historically high pessimism.

As advisors encourage their clients to stay the course and play the long game, unsurprisingly, some investors get cold sweats about the value of their retirement accounts. Some even consider doing something drastic, causing advisors to turn partly to behavioral finance – the study of the effects that emotions and biases have on investors' decision-making – to calm clients and encourage adherence to their investment strategies. At the same time, advisory firms are under pressure to flexibly scale, streamline costs, and efficiently service portfolio changes while delivering high-value services to their clients.

Some advisory firms are looking not only to outsource trading and other functions, but also to do so in a more holistic way alongside automated platforms that can offer powerful rebalancing, order management and more. This direction often comes as part of a broader technology strategy that allows them more time to focus on client relationships.

Stepping into the role of both financial advisor and portfolio builder, it is essential to understand clients' overall goals and protect their financial well-being, but where does the value come from?

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>
> Jamie Dimon, JPMorgan Chase CEO

Advisors adopting behavioral finance techniques

Behavioral finance focuses on explaining why investors often appear to lack self-control, act against their best interests, and make decisions based on personal or emotional biases instead of facts. Persistent investor pessimism drives advisors to increase their focus on behavioral finance amid continued market volatility and inflation, slowing economic growth, and amplified chatter about the possibility of a recession. After four decades of unprecedented market performance, talk of a potential "lost decade" drives even more fear among investors.

More than half of financial advisors worldwide say that incorporating behavioral finance in their practice helped keep clients invested during market volatility, and 48% increased client retention thanks to behavioral finance.[2] From 2020 to 2021, advisors reported that behavioral biases were much more evident due to the stresses of the pandemic, according to a Schwab Asset Management study,[3] while 2022 has had even more bias with increased energy prices, war, inflation, and the looming threat of a recession. Recent weekly investor sentiment surveys conducted by the American Association of Individual Investments (AAII)[4] indicate historically bearish, low optimism – below the historical average for the 30th time in 41 weeks and among the 60 lowest readings in the survey's history.[5]

The surge in biases is likely helping advisors see the effectiveness and benefits of behavioral finance techniques more clearly than ever. Advisors reported markedly increased effectiveness when employing fundamental bias mitigation techniques such as taking a long-term view (76%), integrating goals-based planning (75%), and implementing a systematic process (66%) as the top three.[3]

This effort could simply be focused more on the benefits of asset allocation and rebalancing. Many advisors are working to replace their clients' strong emotions with tactical rebalancing, tax-loss harvesting, and making incremental portfolio adjustments to make sure clients are where they need to be.

↑48%

increased client retention thanks to behavioral finance.

The power of personalized portfolios at scale

While today's investors demand tailored models that fit their preferences per rules and exceptions, concerned clients require even more attention. A personalized approach and scalable, fast, and thorough responses to questions and preference adjustments can help advisors reduce bias and strengthen client relationships.

Client communications and portfolio construction provide important avenues for advisors to implement behavioral finance techniques. 75% of advisors use portfolio construction to identify clients' investment biases and show how they purposely avoided incorporating them into portfolio construction strategies.[3]

Advisors must be adaptable and able to tailor models to a client's situation using rules, parameters, and exceptions, which is powering the need for increased portfolio modeling precision. This includes intersecting trade restrictions and hypothetical investment decisions or applying rules for select periods.

Exploring tax-loss harvesting opportunities and what-if scenarios is also important to better position clients for the future. Behavioral finance users are more inclined to use tax-loss harvesting and a phased investment approach.[3]

Today's clients also want more transparency, wealth, and asset preservation, and socially and environmentally responsible investing. Advanced rebalancing and reporting can support complex asset classes and portfolios, offer options like split compensation and separately managed accounts (SMAs), and provide customized investment policies and reporting.

Advisory firms also need to scale by processing many accounts, 1,000 or 20,000 or more accounts per day, in a timely fashion while effectively managing all the related data. They must be able to scale across functions regardless of the number of individuals within the firm who have a hand in any particular trade.

Rebalancing scalability and efficiency should be the same for a small firm – where one person would wear the hats of model manager, advisor, portfolio manager, trader, and compliance officer – and a larger firm where these functions are distributed across different individuals or departments.

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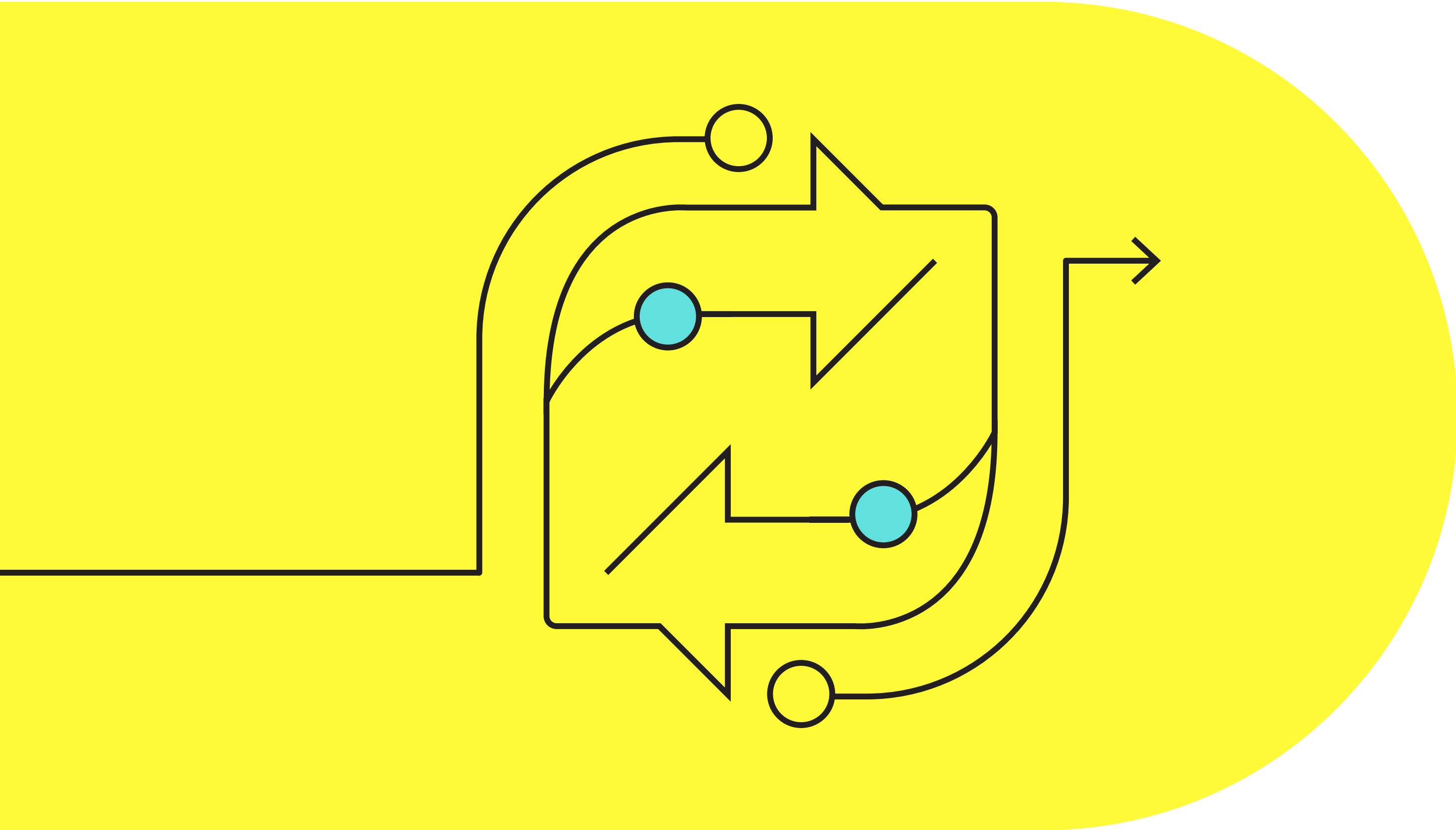
BeFi Barometer 2021: Addressing a Surge in Client Behavioral Biases,

Advisor tech stacks demand flexibility and differentiation

Advisory firms are more driven than ever to streamline operations, free up valuable time and focus on growing other strategic areas of their business. At the same time, portfolio managers need to support diverse client needs, challenging multi-asset classes, and complex scenarios.

As markets continue to grow in complexity and investors expect greater customization with lower fees, more advisory firms are considering outsourcing different functions such as trading, investment, and practice management in combination with technology platforms. According to a TD Ameritrade study, 71% of advisors outsource at least one function.[6]



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Outsourcing trading might help control costs and give you more scale and the ability to free up portfolio managers to rebalance. In addition, outsourcing investment management, such as through intelliflo managed, could be a viable option for turnkey middle- and back-office functions and access to model portfolios from leading asset managers and strategists.

But outsourcing rebalancing must be assessed carefully, especially if rebalancing is a central part of a firm's value proposition. While an outsourcing option may still provide tax-sensitive transitions, ongoing tax-loss harvesting, drift monitoring, and daily portfolio reviews, it may not support sophisticated client needs like householding, complex portfolios, or integrate well within your ecosystem.

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Delivering more value while reducing complexity

With volatility and uncertainty becoming the norm, the demand for personalized client experiences has increased as investors seek guidance on navigating many complex emotional biases and financial impacts. As a result, advisory firms are faced with many choices of platforms to help set their clients on the right path consistent with widely accepted behavioral finance techniques.

While the outsourcing trend is taking off, firms should avoid taking an “all or nothing” approach and, instead, be selective in what they choose to outsource or keep in-house. Firms have the option to keep some core functions in-house and outsource others. Still, when it comes to rebalancing and trading, options vary widely in their ability to personalize at scale while supporting the needs of diverse sets of clients.

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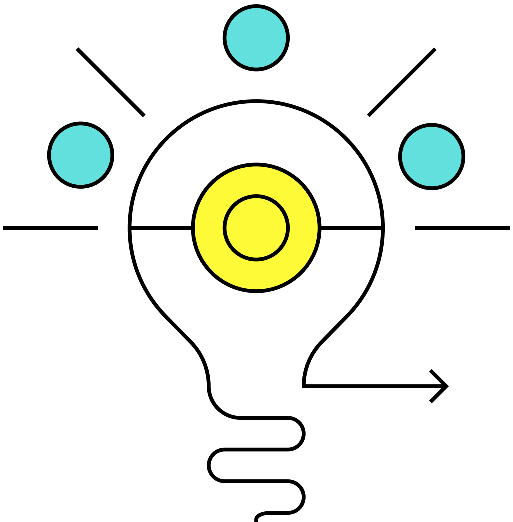

Rebalancing and trading remain vital components of the value advisors provide, but advisors doing their rebalancing should not have to compromise. When assessing rebalancing platforms, a firm's decisions should be driven by the sophistication of an advisor's client portfolios and asset allocations, and each key function's role in the firm's mission and differentiation.

The ability to tailor services while also scaling quickly to meet all client needs cannot be underestimated in today's environment. An advanced rebalancing solution is the best way to reduce friction around service and scale – and spend more time delivering value to clients.

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Sources:

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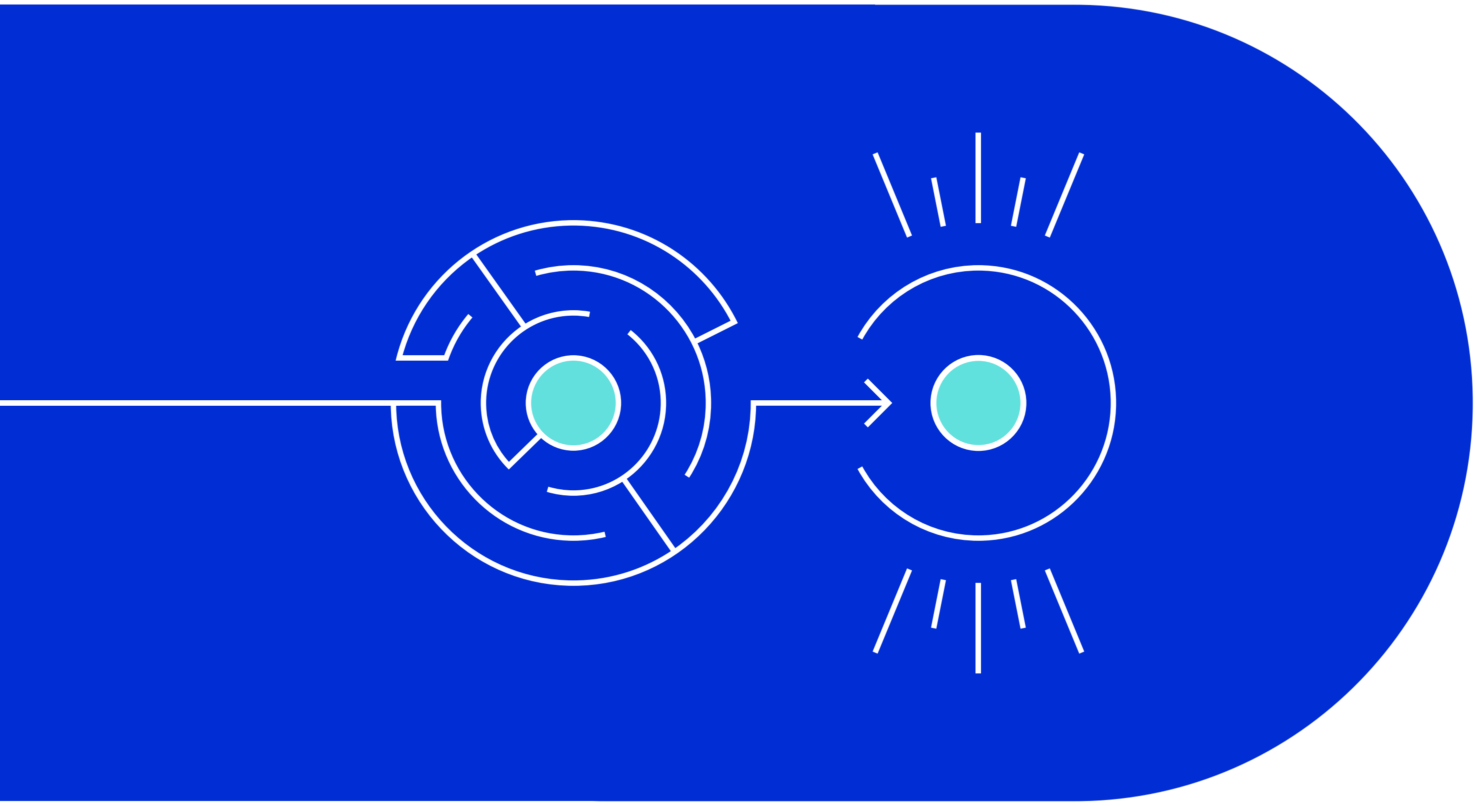

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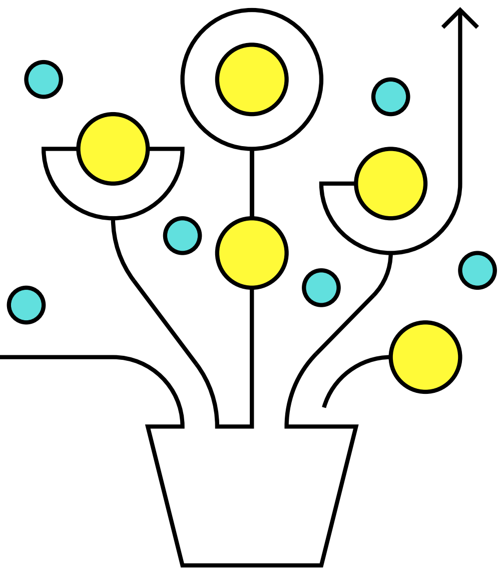
Our solutions support over 30,000 financial advisors worldwide, representing over three million end-investors, with over $1 trillion serviced across our platforms.



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