Investor demands and demographics are shifting – are wealth advisors ready?

How wealth managers' response to rapidly evolving investor demands, preferences, and behaviors will determine their growth trajectory.

Introduction

Ongoing market volatility is prompting investors and wealth managers to recognize the value of portfolio diversification in distributing risk across geographies, industries, and asset classes. The wealth management industry is adapting to a sea change in investing as the market's prognosis for the short term remains subdued and hazy due to shifts in returns and investor sentiment following a lengthy bull market and low yields.

As such, investors' appetite for new portfolio strategies, such as direct indexing and alternative and private market investments, drives wealth industry capabilities beyond cryptocurrencies. In addition, wealth management firms are also beginning to refocus on earning the trust and wallet share of the mass-affluent segment and meeting the specific needs of women as they increasingly control more wealth, which is driving more emphasis on customer-centricity and personalization.

Demand for outsourced chief investment officer (OCIO) services and family offices is also rising as wealthy investors seek higher portfolio returns using tax-efficient investment strategies and low-fee trading environments.

Technology advancements will not only help wealth advisors scale by automating manual advisor functions; they will help make customizable portfolios available to more customers seeking tax efficiency, diversification, personalization, and values-based investing while wealth advisors strive to expand their client bases to mass-affluent, women, and younger investors. As a result, wealth firms want to be able to scale portfolio personalization to meet the growing demand for segment-driven advising.

Here, we examine the critical investor trends shaping wealth firms' future investment, growth, and digitalization strategies.

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Leveraging alternatives and private equity for downside protection

The alternative investment category is vast, comprising a variety of unlisted assets, including private equity, private and distressed debt, growth capital, hedge funds, managed futures, certain commodities, derivatives, real estate, tangible assets such as antiques and art, and cryptocurrencies.

Once the exclusive realm of institutional and ultra-high-net-worth investors (UHNWIs), alternatives have gained ground with retail clients. Because they are uncorrelated with traditional markets or interest rates, supporters say these unlisted and largely unregulated assets offer improved diversification and outsize long-term returns.[1]

Amid inflationary pressures and swaying markets, some investors are losing confidence in the traditional 60-40 stock-bond portfolio mix to provide the required diversification and returns. Wealth managers will likely respond by advising clients to diversify into commodities, such as energy-related and precious metals, and alternative investments.[2]

A recent Cerulli survey of advisors working with affluent clients (with a net worth exceeding $5 million) found that their allocations to alternative assets were expected to rise from 7.7% in 2020 to 9.1% in 2024.[1] Growth opportunities and portfolio diversification were the top reasons cited by 50% of advisors.[1]

More investors are pursuing private markets to offset short-term volatility, hedge against inflation, and boost longer-term returns. By 2024, 46% of high-net-worth investors (HNWIs) will invest in private markets, up from 29% in 2022.[3]

Investment managers who assert waning support for the traditional 60-40 model argue that private equity could create a new one.[4] Private equity investments have traditionally offered higher returns and lower volatility over the long run and can typically withstand challenging market conditions better than their more liquid peers.

> A regularly rebalanced portfolio can be a safety hedge within a dynamic investment environment.
>
> Source: Capgemini, Top Wealth Management Trends 2023

Mercer's 2022 Global Wealth Management Investment Survey showed that 58% of 125 wealth managers surveyed already invest in illiquid assets, and 15% are considering investing in the next 12 months.[2] The same survey revealed that private equity remains the top choice among wealth managers, with 58% stating it is their first investment preference among alternatives.[2]

Regarding cryptocurrency, confidence has been eroded by the recent decline in asset prices and a sizable number of crypto natives. Digital assets will not likely be able to realize their maximum potential or be valuable to most businesses until trust returns – which could become a competitive advantage for some players that succeed in rebuilding that trust.[5]

Technology will be critical in helping relationship managers respond to investor demands to incorporate alternative investments in diversified portfolios.[3]

HNWI and ultra-HNWIs seek to rebalance their portfolios, resulting in an active shift to alternative investments, especially private equity.

Source: Capgemini, Top Wealth Management Trends 2023

Tax and personalization benefits of direct indexing

Direct indexing strategies are going mainstream and gaining the attention of mass affluent investors. Once reserved for UHNWIs through separately managed accounts (SMAs) due to its tedious nature, a direct indexing strategy can provide greater customization than can be achieved with ETFs or mutual funds while helping to minimize taxes through tax-loss harvesting – an attractive characteristic considering the market volatility experienced over the past few years.

Direct indexing assets are expected to grow at an annualized rate of 12.3% over the next five years – outpacing ETFs, mutual funds, or retail separate accounts – and make up 33% of the retail separate account market by 2026.[6]

The surging demand for direct indexing products and services is due to their ability to enable customizable client portfolios based on values and preferences. In addition, technologies related to direct indexing, which allow portfolio customization at scale, will extend the capability of asset managers to offer advanced portfolio solutions to smaller clients.[7]

Although assets in direct index products reached $462 billion in 1Q 2022, growing at a 15% rate from 2Q 2021, many advisors with clients well-suited for direct indexing are not using these strategies in their practices.[6] Recent Cerulli surveys show that only 14% of financial advisors are aware of, and recommend, direct indexing solutions to clients – despite 63% of financial advisors serving clients with a core market of more than $500,000 in investable assets and 14% targeting a core market of more than $5 million.[6]

Real-world advisor use cases for direct indexing implementations include tax-loss harvesting, trimming highly appreciated stock positions, planned charitable giving, ESG and values-based investing, customized fixed-income ladders, and custom-weighted indexing.[6]

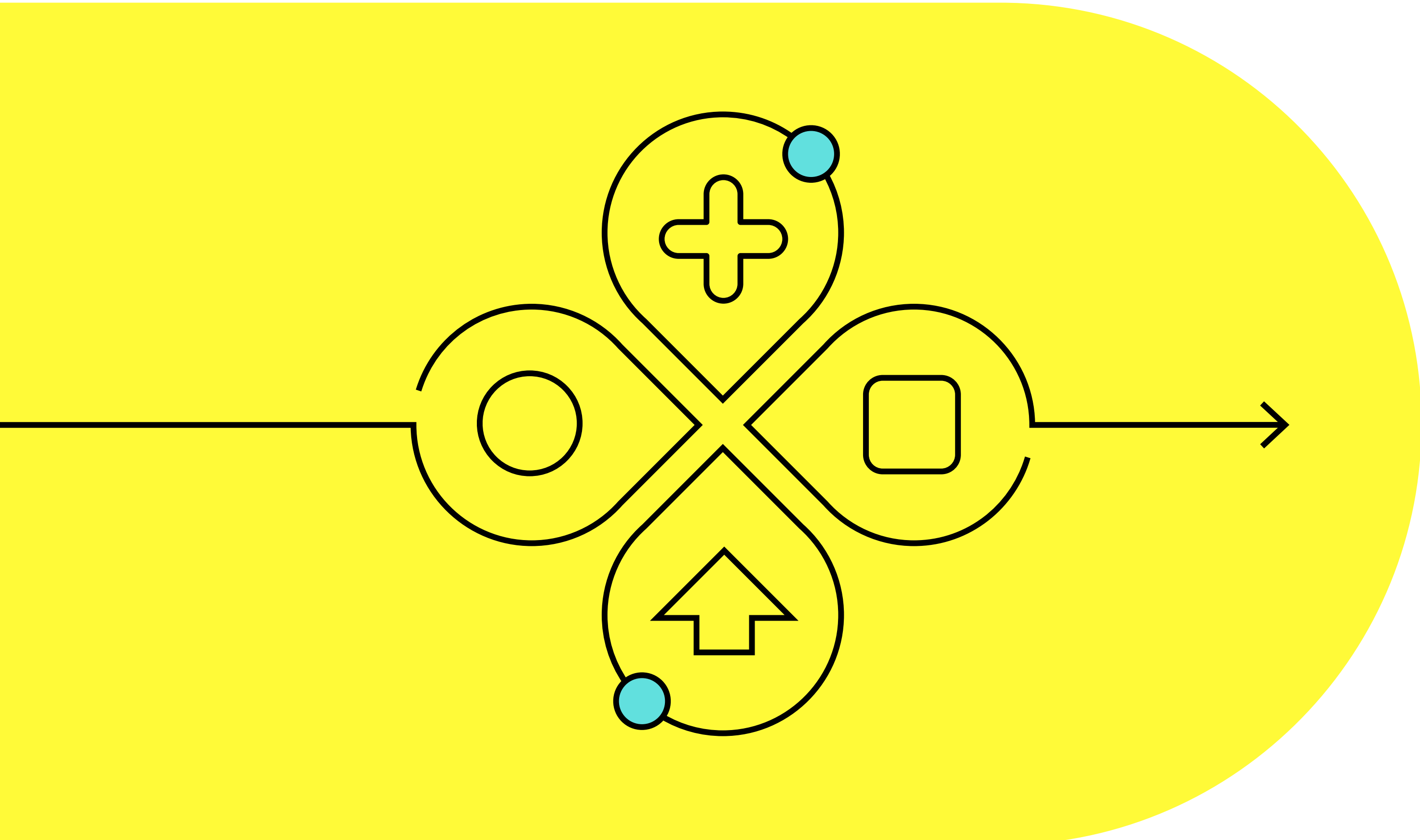
The combination of portfolio rebalancing and optimization software allows any wealth or asset manager to launch their own direct-indexing solution.

Source: Javelin, 2022 Trends & Predictions, Wealth Management – Advisor

Spotlight on thematic, value-oriented investing

Investors' value-based objectives frequently take a backseat to their desire to realize the best returns possible in a year of declining markets. However, the drive to own businesses that behave responsibly as corporate citizens shows no indications of abating. It is most likely to grow over the next year and the years to come.

The next generation of investors, including those who will receive the largest wealth transfer in history in the coming years, share similar investing priorities as the wealthy. As a result, environmental, social and governance (ESG) is being incorporated into investment products, and firms are integrating ESG principles into the heart of their purpose, strategy and performance management.



ESG assets under management in the U.S. are expected to more than double, from $4.5 trillion in 2021 to $10.5 trillion in 2026.[5] Bain & Company forecasts that ESG-related assets will constitute about 46% of all AUM by 2030 versus 33% currently.[2] In particular, sustainable net-zero investments by private wealth clients are growing rapidly, with 75% percent of wealthy millennials considering ESG a crucial factor in investment decisions.[2]

Differentiated thematic investment strategies providing exposure to decarbonization and the energy transition are finding a receptive base of clients, particularly in the private markets.[7] Because the rapid growth of sustainable funds has attracted both political attention and regulatory scrutiny, near-term uncertainty around disclosure rules will likely lead to a pause, at least in the regulated fund segment. In contrast, demand for sustainable products continues unabated from some core institutional segments and asset managers.[7]

Winning wealth managers will offer their (ultra) high net worth clients access not only to top-branded funds, but also to direct co-investment opportunities and niche, thematic, or ESG impact-focused funds.[8] Surprisingly, advisors are hesitant to discuss ESG with individual investors. More than half of advisors wait for their clients to broach the subject.[9]

Advisors who can offer sustainable investment opportunities will be better equipped to attract new clients, retain existing ones, and keep pace with a changing investor landscape. By integrating customized ESG themes into models using an advanced rebalancing and trading platform, advisors can shift seamlessly to fully satisfy their clients' ESG and other thematic preferences and requirements.

Meeting the specific needs of underserved and growing customer segments

To grow and succeed, wealth advisors will need to be able to capture a wider customer base. Wealth management is no longer limited to HNWIs and UHNWIs. In recent years, there has been an influx of affluent millennial clients seeking assistance on investments, insurance, and tax planning in the private wealth space.[2]

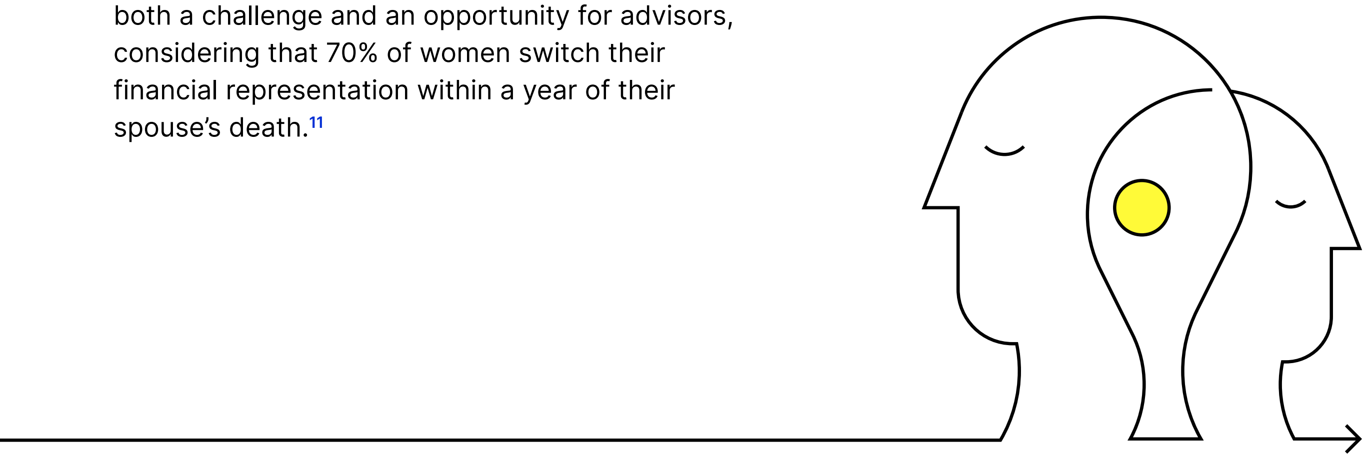
Intergenerational wealth transfers of $84 trillion are expected through 2045 in the U.S.[2] Staying ahead of the curve in capturing the younger client base could be a key business accelerator for wealth management players. In addition, women represent the next phase of growth in wealth management.

Today, women represent more than 40% of high-net-worth individuals globally, and the share is expected to grow strongly over the next decade.[8] Women now control a third of U.S. wealth – about $10 trillion – and by 2030, that number is expected to balloon to about $30 trillion[10] as financial assets shift into the hands of women. This shift represents both a challenge and an opportunity for advisors, considering that 70% of women switch their financial representation within a year of their spouse's death.[11]

However, many wealth management firms misjudge their requirements, leaving women underserved and most wealth management firms lack segment-specific products and services, with only 37% providing unique offerings for women.[12]

While women seek healthy returns and purpose-driven investments like other investors, goals such as connection, meaning, next-generation legacy, and making a social and environmental difference are also important. In addition, today's HNW women demand value-added services around retirement (75%), inheritance planning (75%), legal support (71%), and tax consultation (76%).[12]

The winners in the industry will fundamentally review their strategy to serve women, mass-affluent, and younger investors and embark on a transformation of their value propositions. Leaders who have already started this process have observed revenue boosts of around 10%.[8]



The increasing appeal of OCIOs and family offices

Demand for OCIO services and family offices is on the rise. As asset owners plan to increase allocations to emerging markets debt, private debt, infrastructure, and real estate investments, they are increasingly drawn to the OCIO model to manage sleeves for alternatives and private asset classes. Asset owners polled by Cerulli Associates said the most mentioned topics of interest over the next year are allocation questions (77%) and questions concerning current portfolio holdings (69%).[13]

Family offices have historically demonstrated a long-term vision for multi-generational wealth through all-in-one convenience and hyper-personalized services. Today, they are emerging as sophisticated players in the wealth ecosystem as investors seek investment diversification, customized service, and a personal touch.[3]

52% of HNWIs prefer family offices because of their one-stop-shop convenience and personalized services, while 49% said they appreciated their service costs compared with traditional wealth management firms.[12] 80% of family offices report investing in private equity, which stands out as the only asset class where the number of family offices making allocations has risen steadily year after year.[14] This is up from 77% in 2021 and 75% in 2020.[14]

Single- and multi-family offices, OCIOS, and registered investment advisors (RIAs) serving sophisticated, multi-generational clients must continuously meet or exceed their expectations. Delivering a high level of tailored investment and portfolio services relies on the right rebalancing and trading technology to meet complex needs, simplify that complexity, and scale efficiently across the entire client base.

A rebalancing and reporting solution should be flexible and powerful enough to meet the sophistication family offices, and their clients demand. Many advisors and investment counselors seek more advanced rebalancing capabilities to handle different client needs and scenarios.

Automating for personalization and scale

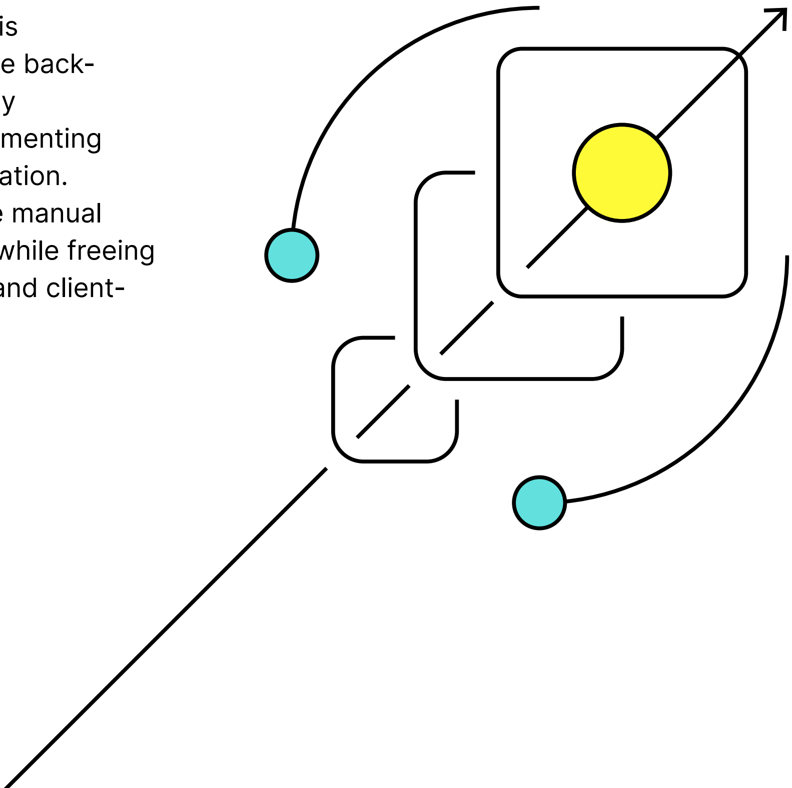
The wealth management ecosystem faces disruption on numerous fronts. Regulations and governance complexities, volatile markets, rising cost pressures, and evolving investor demographics, preferences, and behaviors have made profitability concerns top of mind for many wealth management executives. As a results, clients are searching for true asset partners to assist them in navigating uncertain times.

Market volatility has demonstrated the value of owning a mix of investments that can serve needs besides long-term growth, such as risk management and inflation protection. Today's clients want more transparency, reduced tax burdens, wealth and asset preservation, socially responsible investing, and the flexibility to include alternative investments to meet their needs and goals. Advisors who genuinely provide diversified portfolios that satisfy a range of goals will be noticed.

55% of firms' relationship managers say demand for personalized services and engagement is increasing.[3] Many client-centric tasks are back-office in nature, and significant efficiency improvements may be possible by implementing updated technology and process automation. Automating and digitalizing high-volume manual processes can reduce costs and errors while freeing advisors to work on higher-value tasks and client-facing activities.

Advisors need to be able to tailor services while also scaling quickly to meet a more diverse range of client needs. A rebalancing solution must also offer modeling flexibility using top-down models, asset location optimization, restrictions, equivalences, compensation, and target overrides while handling illiquid alternative assets and taking them into consideration during a rebalance. Regardless of the complexity of a firm's investment strategies, clients and portfolios, rebalancing should be seamless and straightforward.

With increased alternative and thematic investments and the call for more personalization adding to model and process complexity, 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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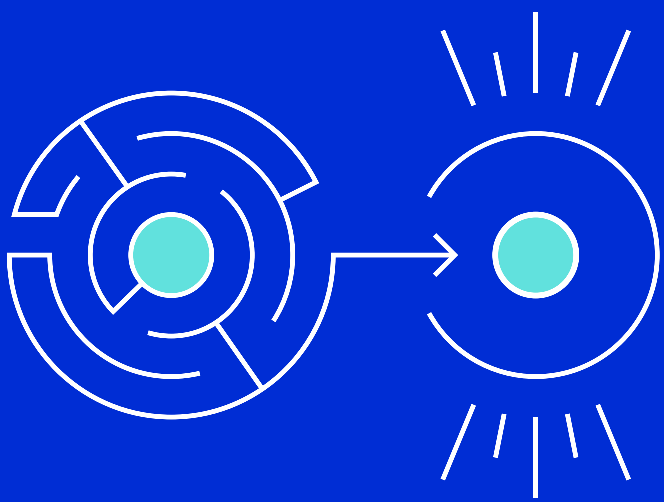

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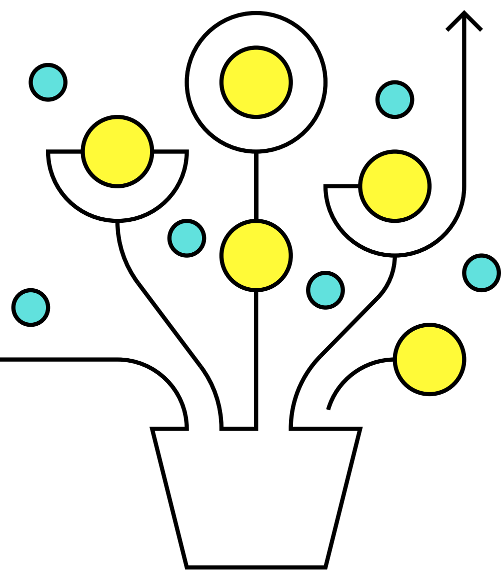

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