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Rebalancing's crucial role in model portfolio customization and scale

How dynamic modeling and flexible rebalancing can help advisors differentiate, grow, and expand their client reach

Introduction

Model portfolios are increasingly popular among financial advisors looking to use time savings to fuel their business growth and scale their services. Rebalancing plays a valuable role in making them more flexible and dynamic as advisors demand greater customization and control.

As investment advisors and family offices seek to accommodate more clients, the demand for scalable customization of model portfolios is on the rise. 13% of advisors primarily outsource client portfolios to a model suggested by broker-dealers, advisory TAMPs, asset managers, or third-party strategists without making modifications.[1] In comparison, 26% of advisors rely on similar third-party resources but make modifications to the portfolio to fit clients' needs or preferences.[2]

Today's portfolio management systems rarely come without a rebalancer that can handle drift, exceptions processing, models, tax awareness, and trading constraints while also incorporating tailored portfolios to client goals in financial planning.[2] However, independent rebalancing platforms with the required integration can offer a greater level of customization, flexibility and sophistication advisors need to serve clients with more complex needs.

Whether advisors use outsourced model portfolios, create their own, or use a combination of both, a flexible and dynamic rebalancing and trading process can help advisors respond effectively to the needs of their clients, investment managers, and portfolio managers.

Model portfolio adoption on the rise

The traditional alternative to creating personalized portfolios from the ground up is time-consuming, difficult to implement effectively, and challenging to scale in practice. As a result, advisors are turning to model portfolios to enable them to take on more clients, spend less time on investment management, and expand their service offerings such as financial planning.

Advisors using model portfolios were able to lower their time commitment to investment management to less than 10% – a substantial decrease from 18.5% of time spent on practice-level models and 29.5% on fully customized models.[3]

Model portfolios also have a fee edge over their mutual fund competitors. In addition, a model portfolio tends to cost less on average across all US allocation categories, even when compared to "unbundled" mutual fund shares with the lowest built-in expenses.

Turnkey asset management platforms (TAMPs) are growing, and investment managers are expanding the model portfolios they offer. Third-party model portfolios had a total of $4.9 trillion in total assets as of year-end 2021, experienced a 22% growth rate from June 2021 to March 2022, and grew an average of 18% annually over five years.[4]

Model portfolios offer guidance while allowing advisors to optimize portfolios and achieve better client outcomes. Pre-baked model portfolios offered by TAMPs and fintech-driven model marketplaces enable wealth managers to effectively rent the intellectual capital of leading outside money managers.[5]

More time for financial planning

One potential area of consideration for rebalancers is their ability to incorporate tailored portfolios to client goals in financial planning.[2] Researchers say the industry's slow and steady transition toward a financial planning-oriented service model will be a powerful impetus for adopting model portfolios.[3]

Financial planning is often a time-intensive process and can quickly become unprofitable in standard asset-based fee arrangements, particularly when working with less affluent investors and next-generation inheritors.

Investment and financial planners are currently the largest advisor practice segment. That number is expected to grow as advisors work more closely with clients (82% of advisors' clients are expected to receive targeted or comprehensive financial planning services in 2023).[3]

Advisors increase their financial planning offerings

82%

of advisors' clients are expected to receive targeted or comprehensive financial planning services in 2023.

Source: Cerulli

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Growing demand for customization, tax optimization and flexibility

As model portfolios continue to gain traction, the demands from broker-dealer home offices and individual registered investment advisor (RIA) practices for a customized product are beginning to increase.[6]

Model portfolios are a good starting point for smaller firms, allowing for customization by adjusting the specific exposures built into the model to a household. But some advisors are looking for more flexibility and sophistication to actualize an investment philosophy and best investment ideas into a single cohesive portfolio and implement it across their entire client base. Taking legacy holdings into account and making investment decisions with tax consequences in mind are also desirable. Some advisors see portfolio management as a core component of financial planning.

Uneven adoption of models to date by financial advisors speaks to several factors, including the generic profile of many models, the hesitation in admitting to clients that they are not building the portfolio themselves, the cost embedded in full portfolio management outsourcing solutions, and the scaled-back versions in which advisors may trade and rebalance on their own.[5]

RIAs are asking model providers for custom models for tax awareness and planning and substitution of investment vehicles, investment tickers, or managers. High-net-worth clients, for instance, may require more personalization to maximize returns on private equity and hedge fund investments.

Operationalizing model portfolio customization

Hirtle Callaghan & Co. wanted to customize its model portfolios further to meet each client's needs. So the firm worked with intelliflo redblack to develop a new capability that enables it to apply a base 60/40 model and augment it with target overrides to modify allocations to client-specific needs – offering simplicity and scalability without sacrificing the ability to tailor models to client needs and preferences.

Learn more

The need for dynamic models and flexible rebalancing

The effective use of model portfolios can improve scale, service differentiation, and customization for maturing and fully mature practices with a rebalancing and trading process. This provides the flexibility and control to handle different client scenarios around models, strategies, and exception management.

Regardless of how firms acquire or create managed models – whether using third-party firms, building them in-house, or a combination of both – a rebalancing platform should have the ability to bring them in and have the flexibility to shift accurately and appropriately as investment offerings change.

Dynamic model capabilities are especially appealing to firms that use sophisticated models and strategies and need customization and workflows to drive greater scale across rebalancing, trading, and order management. It also makes it more efficient to build and manage a universal modeling strategy and customize clients' retirement and tax strategies at scale.

A flexible rebalancing and trading process – that lets advisors apply changes to multiple positions in a model, a security model, an asset class within a model structure, or a specific portion of an asset class – makes mass portfolio modeling and customization at the account- or household-level a more straightforward process.

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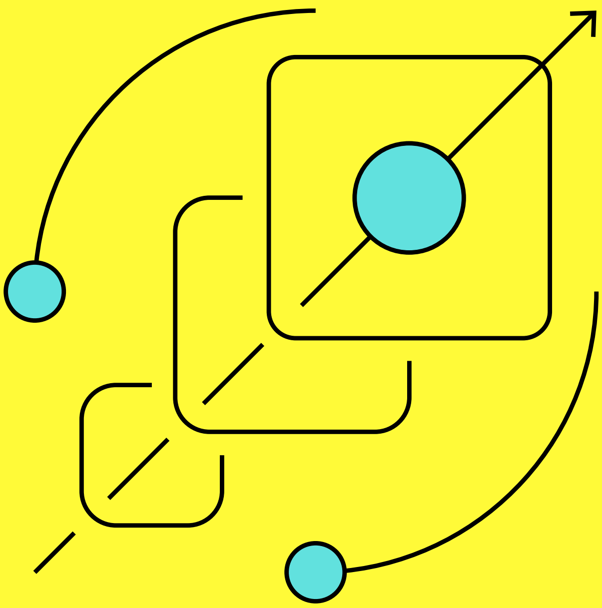
With dynamic models, advisors can create a model against any benchmark, tax-efficiently allocate assets across a complex household, apply asset location preferences, and personalize risk profiling. In addition, a rebalancing software's capability to have model substitutes at the portfolio level allows a change to be made directly at the model level versus applying a full custom model on that portfolio, letting you scale quickly.

In addition, investment managers and advisory firms growing their businesses through M&A face modeling and rebalancing complexity when inheriting books of business. They need the flexibility and scale to put all those models with independent customizations into their managed model structure and allow for additional M&A activity.

Many firms today also want to reduce the number of overly customized models they manage. Without advanced rebalancing software, they could have too many models without the ability to consolidate them into a more manageable number of models.

Using intelliflo redblack, investment manager Vicus Capital experienced seamless ten-fold growth in the number of investment models it manages – reaching approximately 1,200 models – while also increasing asset complexity, creating customization and structure, and boosting efficiencies, accuracy and oversight in trading, and rebalancing.

Learn more



Rebalancing for growth and diverse client segments

Advisors increasingly need to meet the on-demand requests of sophisticated clients across multiple segments, accounts, and households. Advanced rebalancing and streamlined trading can support advisors' growth and diverse sets of clients, advisors, and portfolio models with model-based rebalancing and customization that:

- Reduces potential compliance violations with different levels of restrictions, proactive investment policy validation, and model tolerance checks
- Monitors current drift from models across accounts and households and sends alerts for projected post-trade drift before committing trades
- Makes it efficient and straightforward to rebalance accounts and households to model considering cash requirements, legacy positions, tax considerations and more while executing directed trades
- Allows you create different types of models to implement your investment management strategies, including blended models that improve maintainability and allow sleeve rebalancing
- Provides a two-tier, model-of-models structure allowing you to streamline the process of managing multiple models either for specific client scenarios or advisor security preferences
- Supports sleeve swaps and portfolio-level overrides to give firms maximum control over security selection for a given asset allocation preference
- Enables you to apply drift monitoring and reporting, restriction capabilities, and tactical security weightings, as well as build custom models

"In addition to intelliflo redblack being the best rebalancing platform for our needs, we were also impressed with its householding and multi-tier portfolio modeling capabilities."

Josh Smittkamp, Chief Operating Officer, Dover Partners

The effective use of model portfolios can increase advisor efficiencies and service offerings in maturing and fully mature practices. Model portfolios eliminate the time, effort, and complexity of personalizing portfolios from the ground up while making it easier to scale. Offering a blueprint for asset allocation and fund selection, model portfolios give advisors discretion over underlying fund selection, rebalancing, tactical allocations, and more, which can be customized.

Choosing a rebalancing platform that provides the level of sophistication that matches the needs of your client base is crucial to scale, growth and differentiation.

Give your clients and partners the flexible, dynamic, and customized rebalancing scenarios and models they demand. Reallocate the time saved to building your book of clients, nurturing client heirs, and focusing on high-value tasks such as delivering financial planning services and asset gathering.

"intelliflo redblack cloud's multi-tier model capabilities will be critical as we continue to customize portfolios across different accounts at scale and grow steadily in terms of assets, strategies, and clients."

Steve Tuttle, Chief Investment Strategist, Signet Financial Management

Sources:

[1] What You Need to Know Before Jumping on This Portfolio Trend, SmartAsset, October 17, 2022.

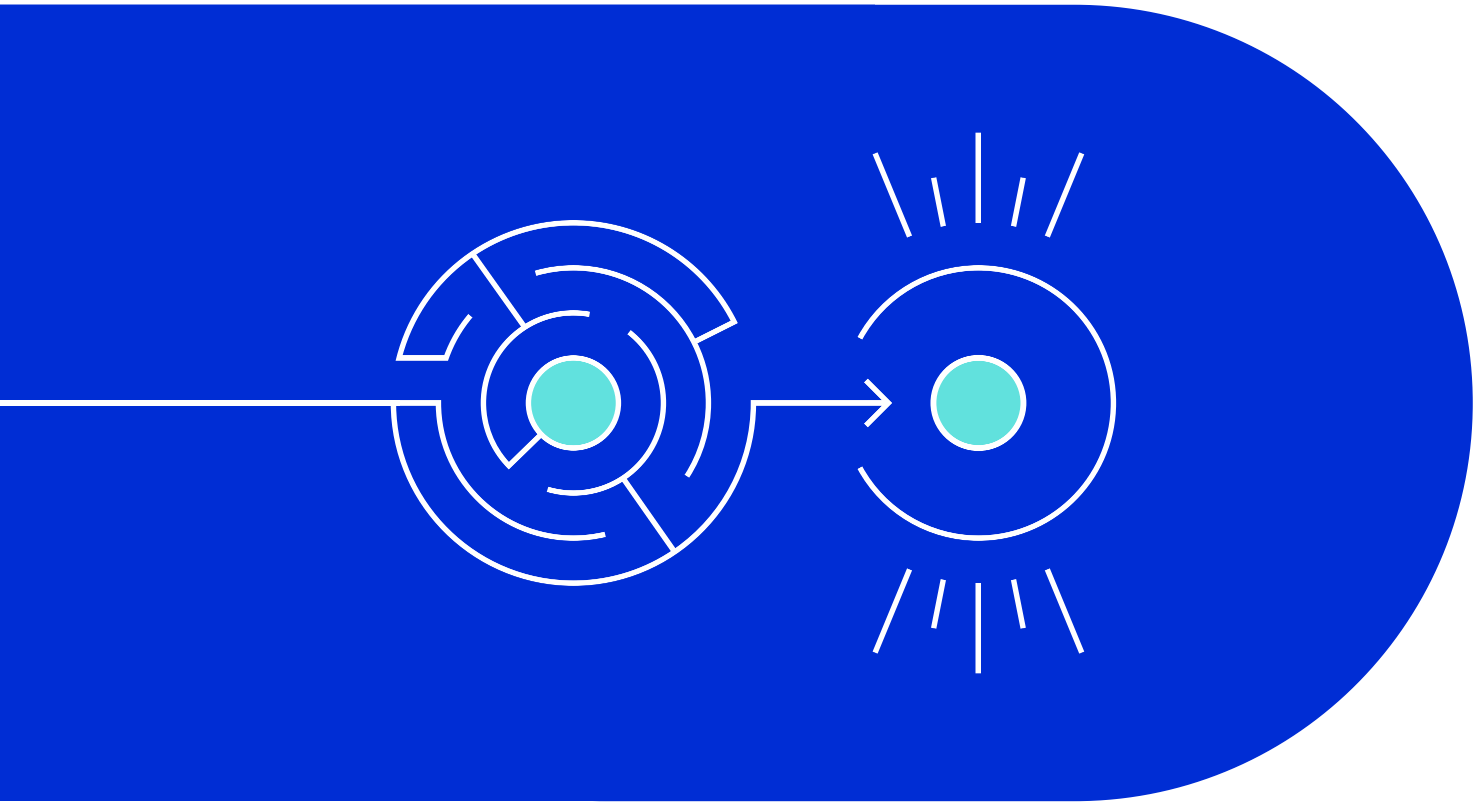
[2] Opportunities to Differentiate Portfolio Management Systems, Javelin, February 2022.

[3] Advisor Demand for Model Portfolios Predicted to Grow, National Association of Plan Advisors, October 13, 2022.

[4] The Great Reset: North American asset management in 2022, McKinsey & Company, October 2022.

[5] 2022 Wealth Management Advisor Trends & Predictions, Javelin, November 2021.

[6] U.S. Asset Allocation Model Portfolios 2022, Cerulli.



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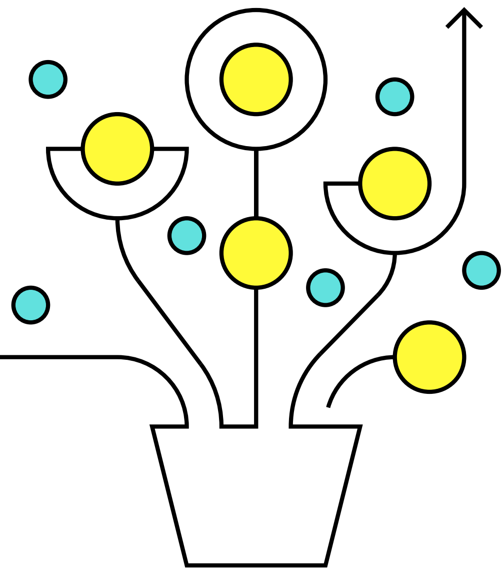
→ About intelliflo

intelliflo widens access to financial advice through leading technology powering the financial advisory experience. We use open software architectures combined with unmatched industry experience to simplify a complex digital landscape to help advisors compete and grow.

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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