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Managing Portfolio Construction

Advisors may not be taking full advantage of the resources available to them.

KEY FINDINGS:

Introduction

Advisors must juggle short- and long-term considerations when they make changes to their clients' asset allocations. They have support for this process in the form of research from home offices and portfolio models that can provide guidance as advisors make these decisions. But these tools generally do not make it easier for providers to offer customized solutions to their clients. This is particularly true at the scale necessary to respond to rapidly evolving client needs and grow assets under management, and at a time when competition among advisors is rising.

"Advisors need to capture next-generation investors through innovation, scaled solutions and by meeting them where they want to be met," says Adam Boyer, SVP, Head of Business Development. However, many advisors are passing on the very tools that can offer this type of support. For instance, solutions for optimizing portfolios and maximizing risk-adjusted returns through direct indexing or portfolio construction experts are currently available but are lagging in terms of their adoption by advisors.

Recently, WealthManagement.com and Informa Engage surveyed financial advisors on behalf of Emotomy to gain a better idea of the how advisors go about adjusting asset allocations for their clients and what types of information they use in the process.

Advisors Focus Mainly On Risk When Constructing Client Portfolios

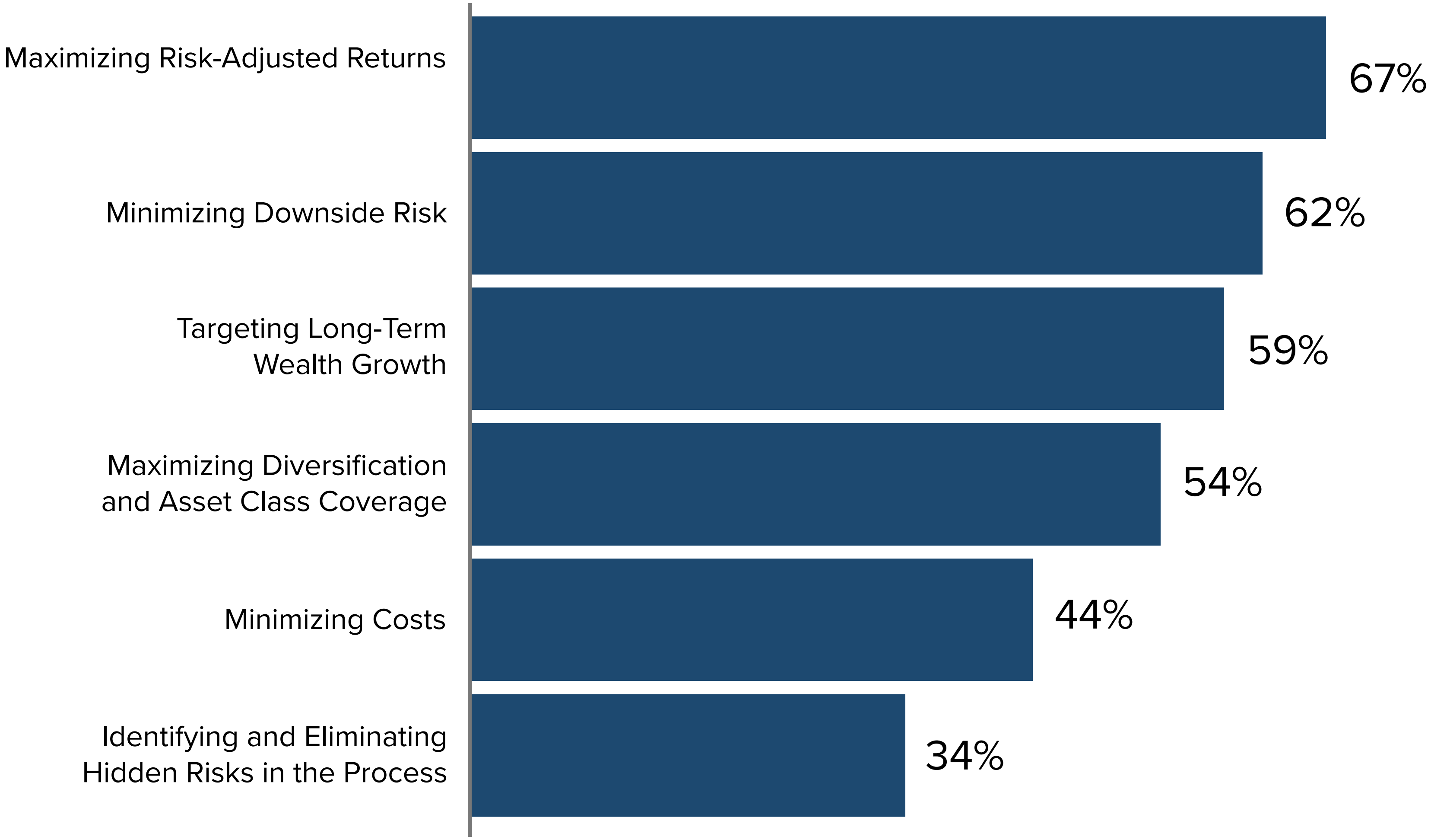
Advisors cite maximizing risk-adjusted returns (67%) and minimizing downside risk (62%) as the two main drivers behind their portfolio construction processes. Other primary drivers include targeting long-term wealth growth, diversification, cost efficiency and mitigation of idiosyncratic risk.

Unfortunately for advisors, risk tolerances vary widely from one client to another. In an ideal world, where client risk tolerances match those of off-the-shelf solutions, advisors would have no need to customize client portfolios. But clients rarely match up perfectly with model portfolios. Moreover, the risk landscape is constantly changing which drives an ongoing need to adjust allocations in step. For instance, more than two-thirds of advisors surveyed (69%) see inflation risk as a primary concern over the next six months. Meanwhile, more than half (54%) are focused on market risks in the form of overvaluation and volatility in domestic markets. Tax risk related to a possible increase in the capital gains tax rate and the need for tax efficiency in portfolios is also a concern in more than half (54%) of advisors surveyed.

A Growing Need For Customization

Shifting risks and a wide range in risk tolerances across clients are driving demand for customized portfolios. Advisors anticipate that increasing client demand for

What Are The Primary Driver(s) Behind Your Process For Portfolio Construction?



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greater tax efficiency, including the adoption of tax harvesting strategies and interest in owning individual securities, are key elements driving the demand for greater customization. Advisors also cite a need to manage concentrated positions to mitigate idiosyncratic risks as another important factor driving this trend.

Once an advisor has constructed a client's portfolio, most of the changes they make to the portfolio's asset allocations are due to changes in the client or the macroeconomic risk landscape. Most advisors (83%) say a change in client goals or risk profile is a very important consideration when adjusting client asset allocations, while six in 10 advisors (61%) also see changes in market outlook as very important.

Since macroeconomic risks influence portfolio customization, analyses that help automate or scale responses to common threats could prove useful for adjusting customized portfolios at scale. However, only a quarter of advisors find shifts in home-office models as very important in driving any changes in their clients' asset allocations, and fewer than one in five (19%) believe third-party models are very important for this purpose.

Home Office Research Helps But Doesn't Drive Advisor Decisions

Advisors' reluctance to rely on changes in home office models to guide their portfolio allocation decisions is reflected in other investment strategy decisions they make. For instance, only 13% of advisors offer home-office asset allocation models to clients with little modification. However,

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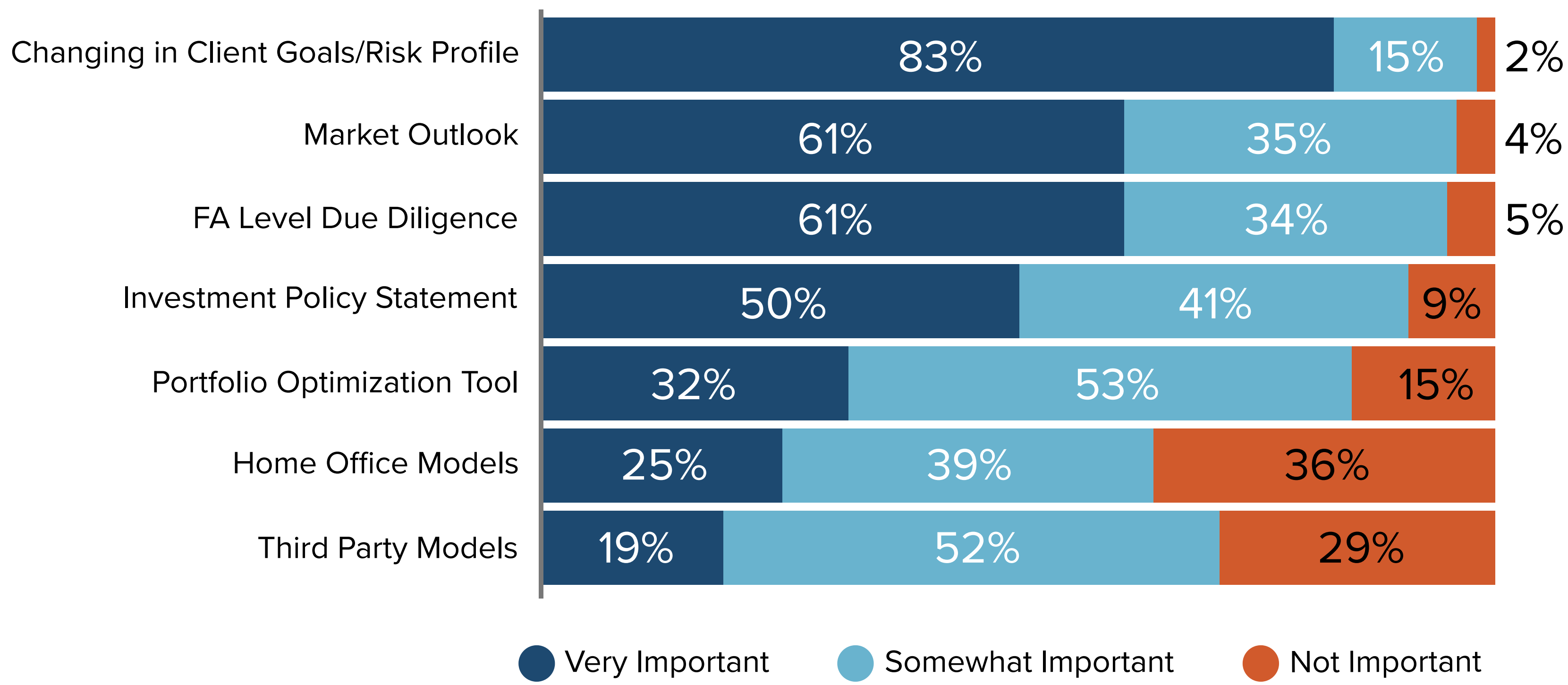
Important Considerations When Changing Asset Allocations



more than a third (36%) report using that information as the basis of their own allocation models. In line with these findings, half of advisors (52%) report minimal to no influence of home office models on their asset allocation decisions. Moreover, advisors report that an average of just 37% of total assets are influenced by the home office research team. Advisors do not expect the value of this research to change over the next two years.

The manager selection process reflects similar attitudes among advisors. Only 13% use home-office research extensively to choose fund managers and 36% use home-office information as the basis for their own selection process. More than half of advisors (52%) indicate they make manager selections on their own or with limited input from the home office.

Third-Party Tools For Outsourcing Portfolio Construction Are Not Frequently Used

Portfolio construction assistance from sources other than home offices appear to be generating even less interest among advisors. Two-thirds of advisors (67%) have no plans to use direct indexing offerings or are unfamiliar with the process. Only 12% of advisors surveyed currently use these offerings.

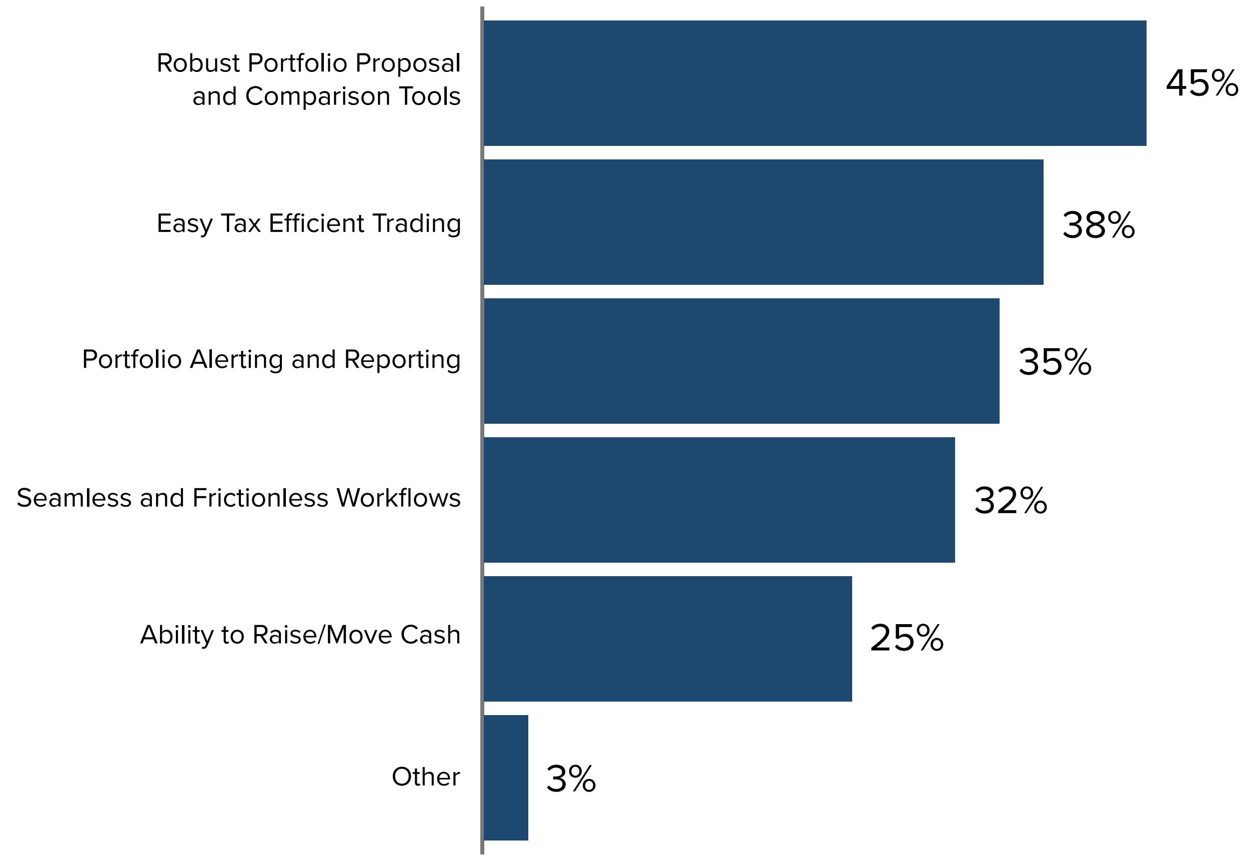
In some cases that may be an effect of limited outreach by these third-party sources; only a quarter of respondents (27%) report recently receiving advice from a portfolio construction specialist at a fund manager. Even so, only 10% of those who received such advice say it led to a product sale. Another 43% of advisors say they have been contacted by a portfolio construction specialist, but have no interest in soliciting their advice.

Unlocking Customization At Scale

The rising need for customized solutions represents a major hurdle for those advisors unable to find deliver those solutions more efficiently at scale. “Advisors need help scaling, and they’re looking for better insights and better analytics to help them grow, reduce their reliance on paper processes and provide better client engagement,” says Boyer.

Perhaps unsurprisingly given the focus of advisors on risks, the key elements advisors seek in a portfolio management platform are those that streamline and support the management of risk and tax efficiencies. Advisors report that robust proposal and comparison tools, easy tax-efficient trading and strong portfolio alerting and reporting functions are their primary considerations when evaluating customization solutions.

Most Important Considerations In A Portfolio Management Platform



Finding the right technology that checks all of these boxes can be a time-consuming process. And as more financial technology companies enter the field and compete with one another, the choices can become paralyzing for advisors, particularly in an industry that has historically been reluctant to adopt new technology.

The presence of digital investment advice platforms, or robo-advisors, appears to be offering a starting point for many in the industry. Nearly four in 10 advisors (38%) currently use a digital investment advice platform to build and/or manage their client portfolios. For advisors looking to take advantage of these types of platforms, the key is finding the right partners to deploy them seamlessly on both the front and back end of an advisor's operations.

As digital investment advice platforms mature, their offerings have become more robust. For example, with the right technology partner, advisors can develop portfolios by customizing a set of modular solutions derived from a third party. "With the right framework, you can craft an approach to respond to macroeconomic issues such as inflation risk either automatically or en masse, reducing the time required to adjust a set of custom portfolios from days to hours or even minutes," says Boyer.

It is worth an advisor's time to find the right solution for their specific situation and needs. Finding the right technology they can trust to fulfill a particular need is essential to their ability to offer clients personalized investment services at scale. Given the general unwillingness to engage with these tools, however, advisors have an opportunity to separate themselves from the rest of the field. Those who make the time to adopt the right technology for them will have a unique value proposition that elevates their client experience above that of their peers, while also providing important growth opportunities.

OVERVIEW: Methodology, data collection and analysis by WealthManagement.com, FUSE Research and Informa Engage.
Data collected June 28 through July 25, 2021.
Methodology conforms to accepted marketing research methods, practices and procedures.

METHODOLOGY: On June 28, 2021, Informa Engage emailed invitations to participate in an online survey to users of WealthManagement.com.
By July 25, 2021, Informa Engage had received 610 completed surveys.

RESPONSIVE MOTIVATION: To encourage prompt response and increase the response rate overall, a live link to the survey was included in the email invitation to route respondents directly to the online survey. The invitations and survey were branded with the WealthManagement.com brand name and logo in an effort to capitalize on user affinity for this valued brand.