A Managed Money Perspective on the Past, Present and Future

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While the Money Management business has had a long developmental history, it began and still has as its cornerstone, the selection of appropriate investment management vehicles that meet the client requirements in a non-conflicted, client-first methodology.

30 Years Ago: The Early Years

Three decades ago—before IRAs, 401(k)s and mutual fund supermarkets—a new investment product evolved from large defined benefit plans to service the small institutional marketplace. This product was the Separately Managed Account or SMA. The corresponding sales approach to promote this product was the modern consulting process. The wirehouse consulting groups like EF Hutton and Merrill Lynch soon won the battle for the small institutional marketplace.

20 Years Ago: The Accumulation Years

Two decades ago, these SMAs started to look outside the small institutional marketplace. For high-net-worth clients, this was a step up from mutual funds, but a step below private banks. Also around this time, IRAs and 401(k)s were introduced as what was the start of the largest experiment in the history of retirement planning up to that time.

In response to these new venues and opportunities in the marketplace, SMAs started to attract the accumulator's money. A practice of "chasing the hot dot" evolved, as consultants and money managers tried to generate returns by following the ephemeral trends of the market. As a result, while sales boomed, the consultative process began to deteriorate.

Mutual fund wraps evolved, providing a vehicle with a built-in response to the major fund supermarkets. The major wirehouses used this strategy for smaller accounts, with minimums as low as $25,000.

10 Years Ago: The Refinement Years

A decade ago, the SMA matured—now able to provide such services as tax optimization and tax loss harvesting, and effective portfolio customization at a lower cost to the client.

During this period other alternative strategies such as MDAs (Multiple Discipline Accounts) and ETFs (Exchange Traded Funds) evolved. Mutual fund wraps grew into more upscale products that attracted more astute investors. The glory days of the large wirehouses as the be-all-end-all of the investment industry was over; TAMPs (Third-Party Asset Management Providers) proliferated into RIA (Registered Investment Advisor) space and Banks entered the managed account industry.

Ironically a burst of consolidation at the turn of the century drew many of these banks further into the financial marketplace through mergers and acquisitions. Among the most notable examples of this new trend: Citi bought Smith Barney, UBS bought Paine Webber, Wachovia bought Pru and Wheat First, the Bank of New York bought Lockwood, PNC bought ADVISORport, and Merrill was purchased by the Bank of America.

Today: It's Déjà Vu All Over Again

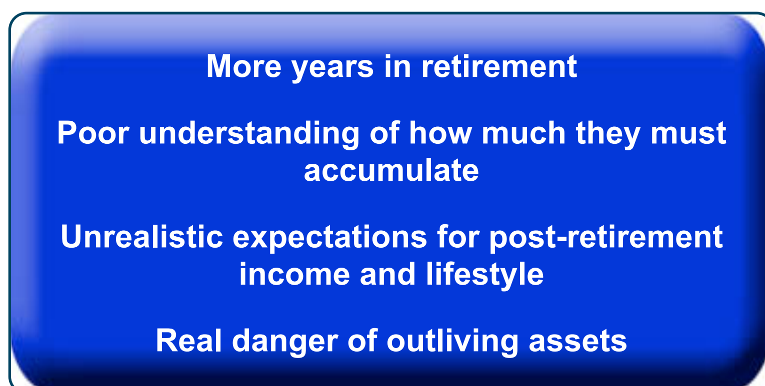
It is a very exciting time to be involved in the financial industry. The Baby Boomers are starting to retire, and will have to face the reality of managing their own retirement plans. The UMA (Unified Managed Account) has been launched. SMAs and mutual fund wraps have come together. Product silos have started to come down. As the great financial experiment moves into phase two, we must ask ourselves: Have we come full cycle?

Introduced		Trillions of Dollars now
1875	Defined Benefit Plans	1.8
1981	401(k)s	2.7
1974	IRAs	3.4
		7.9

Today we are on the cusp of the largest change in the financial services industry in the history of the U.S.

As the baby boomers retire, they will precipitate an unprecedented transfer of wealth, a corresponding explosion of liquid assets, and an urgent need for advice. In this dynamic environment, there is a need for a brand new retirement investment model. One is forced to ask the question, “Can the baby boomers manage their own pension plans?” Furthermore, this time of change comes just as we are beginning to experience the worst economic turmoil in nearly a century.

The Boomers' Current Investment Equation



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Another question we must ask is "What do the affluent and high-net-worth Baby Boomers need? The answer: Their Own Defined Benefit Plan.

This plan would have to be a multi-product solution. The requirements for this solution would include generating enough cash flow to support the client's lifestyle, creating growth so they don't run out of money, securing legacy estate funding—thus providing an inheritance for their children, and allowing for contributions to charity. As more and more Boomers pass retirement age, they will be burdened by steadily increasing medical costs.

For ease of use, these services would best be provided by a one-stop-shop. Such an approach is simple, secure, and convenient—allowing for consolidated reporting, enhanced liquidity, and high levels of service and expertise.

How Does this Major Sea Change Impact the Financial Services Industry?

Many old school rules will have to be tossed out the window. Investors and advisors will need to re-educate themselves. Approaching retirement in this way is a relatively new concept that needs definition.

Retirement becomes defined by stages. First comes the just-retired "honeymoon". Freed from the essential economic problem (work), the new retiree is free to pursue their interests: travel, hobbies, further education, active sports, or other outlets. After this initial experience of newfound freedom, the retiree must come back to reality. For one, they will be leading a more sedentary lifestyle. This can lead to clients becoming disengaged from the investment process, and may cause them to focus more in getting their monthly check than in managing their money wisely.

Another issue is that of health care. With the inevitable onset of the types of health issues common to senior citizens, maintaining independence becomes a daily mission. Among the potential long-term health care issues are extended hospitalization, possible institutionalization, and end-of-life care. If the client does not think ahead and plan to meet the requirements of these issues, he may be faced with dire circumstances.

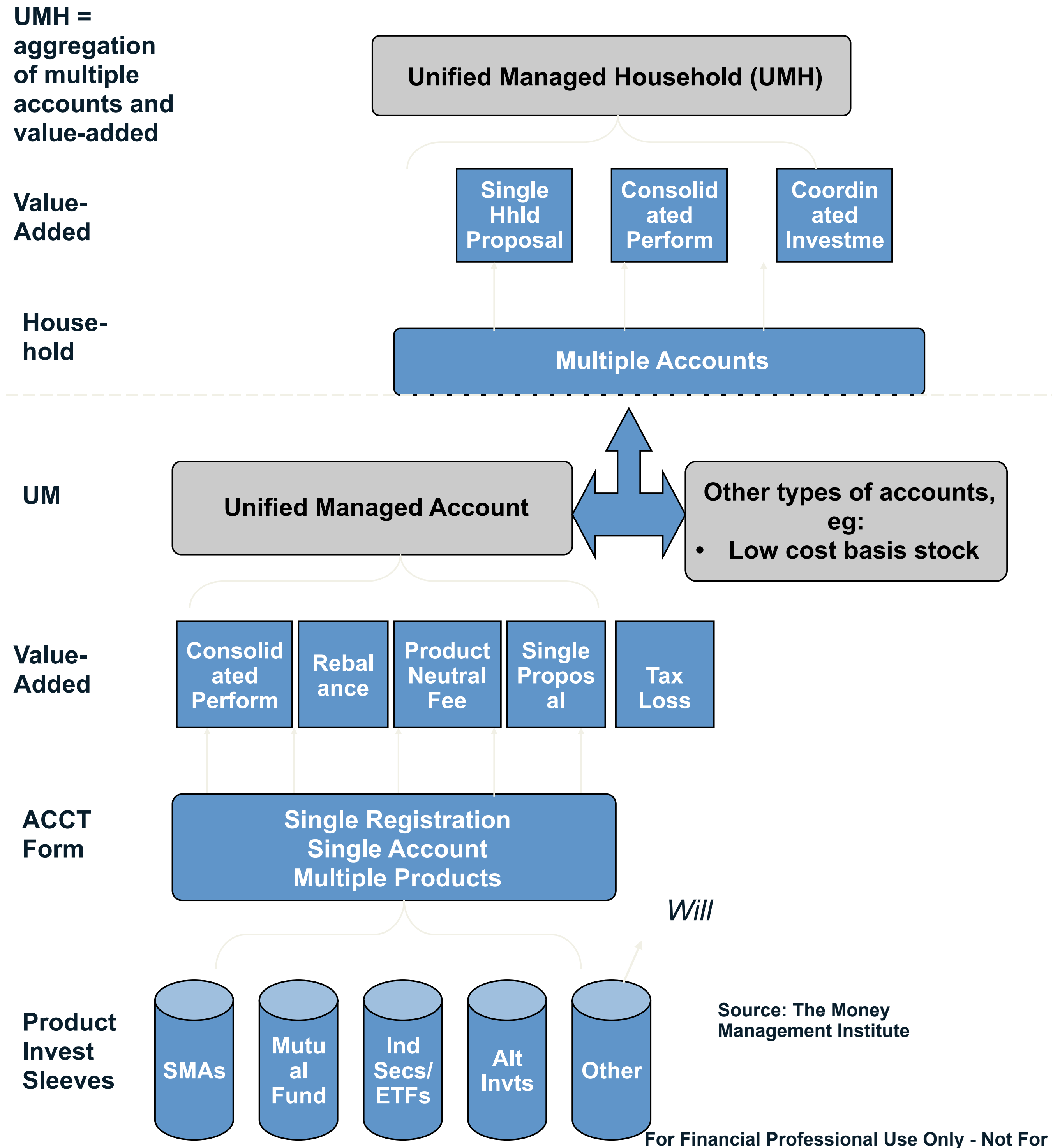
In this environment, the personal pension plan takes precedent. The client needs an inflation-adjusted lifetime income stream, guaranteeing payments at disengagement. Another concern is planning for continuity—generating an ongoing "Living Plan" for each individual. Other contingencies must also be addressed. For example, what happens to the client if their advisor retires? They may need:

—Trustee services

—Security of assets

To meet future medical expenses, the client needs health care coverage guarantees with the payment plans built in. The client must also address the disposition of their Legacy assets through "Estate Planning": how much is left for their children and grandchildren, or for donation to charities.

Today, the Unified Managed Household has become the platform to deliver the personal pension plan. No one product has all the answers. Therefore the client will need a multi-product solution. Given this situation, the distribution of assets is particularly complicated.


UMH = aggregation of multiple accounts and value-added
Unified Managed Household (UMH)
Value-Added
Single Hhld Proposal
Consolid ated Perform
Coordin ated Investme
House-hold
Multiple Accounts
UM
Unified Managed Account
Other types of accounts, eg:
• Low cost basis stock
Value-Added
Consolid ated Perform
Rebal ance
Product Neutral Fee
Single Propos al
Tax Loss
ACCT Form
Single Registration
Single Account
Multiple Products
Will
Product Invest Sleeves
SMAs
Mutu al Fund
Ind Secs/ ETFs
Alt Invts
Other
Source: The Money Management Institute
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Investment Objectives Transition into a 30-Year Living Investment Plan or Life Transitions Planning

In the new modern environment, the living investment plan becomes more important than the estate plan. Each transition needs to be included; not only retirement, but also the financial and psychological aspects of change related to aging. This may include an advisor retiring or otherwise ceasing their business, the death of a spouse, increasing health care costs, and the issue of where and how to live. The living investment plan has to survive any of the individuals or companies servicing the plan. The needs of the client may not change just because their circumstances have.

Wealth Management Brings About Consolidations

The Boomers are consolidating advisors and custodians. As this happens, the wealth manager becomes the poor man's family office. The SMA is no longer the favored product. It has been replaced by a more inclusive 30-year investment plan. The need for advice expands dramatically.

There is a corresponding trend from performance-based sale to a solution-based sale. It is unavoidable that investment strategies and terminology will change. The contrast between dollar-weighted performance with absolute dollar goals becomes more important than time-weighted performance against benchmarks and indices. Risk is redefined as the likelihood of the client outliving their money rather than a measure of periodic volatility. Thus, counter-intuitively, fixed income strategies may have greater long-term risk than equities. Active management will be redefined to include the active management of passive investment vehicles. Managing the monthly drawdown will become more complicated than investing the original money. Immediate annuities and other insurance products will become an asset class to themselves.

Some Observations About Current Issues and Products

#1 The Institutionalization of the Retail Brokerage Business

- Merrill Rule reversal
- Rand study report
- Home office-driven strategies

#2 Mutual Funds Will Plateau While ETFs Hockeystick

- Mutual funds have an antiquated organization structure

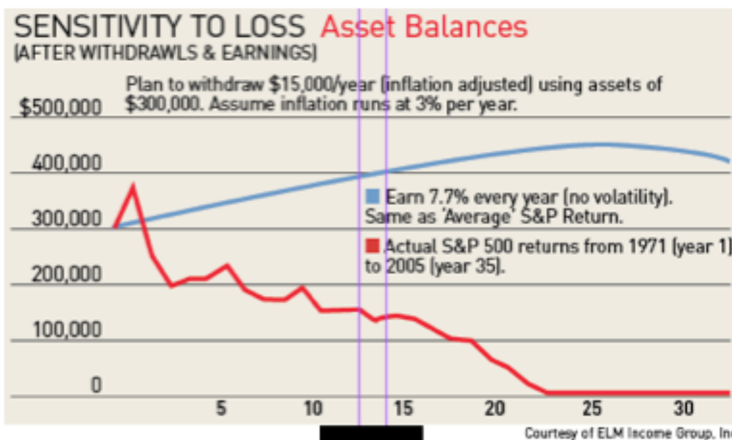
- End of day trading
- Board of Directors
- Trading limitations
- Built-in distribution fees
- Poor tax pass through

#3 Target Date Funds

- What's all the fuss about?
- What is so magical about the retirement date?
- Why should asset allocation change as you approach it?
- Death date funds may be more practical

#4 Insurance Industry Will Partner With the Managed Account Industry

- Guaranteed living income stream on top of a UMA is just around the corner, as expressed in the chart below.



#4 Insurance Industry Will Partner With the Managed Account Industry

- No load
- Assets stay in brokerage account
- Take guarantee off and on
- 100% equity / no need for fixed income

- Benefit can ratchet up with positive performance

#5 Hedge Fund Industry leveraged the sub-prime disaster?!

- Frank's congressional committee missed the boat
- Estimate $4 trillion of deposits
- Estimate 35% in equities at 50% leverage or $2.8 trillion of buying power
- Estimate 65% in fixed income at 10:1 leverage or $26.0 trillion of buying power
- Where is transparency?
- Where is regulation: "The Bernie Factor"
- Why are hedge funds more special than any other managed product?
- Some Observations About Current Issues and Products

#6 Financial Services Industry Doing a Lousy Job of Attracting the Best Young Graduates into the Advisory Business

- Average advisor is 53
- Same recruiting practices as 30 years ago
- This generation is looking for a different compensation structure.
- This is a great opportunity for financial professionals.