How Investor Psychology is Changing – and Wealth Management Firms and Advisors are Responding

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To get an overview of emerging trends in the wealth management business in the United States, one of the best places to go is the annual SIFMA Private Client Conference. This year's conference, held April 10 in New York, was particularly insightful; it focused on the sea-change in investor psychology that has been taking place over the last several years, and the response of the large and small wealth management firms, in terms of long-term strategic decisions and business tactics.

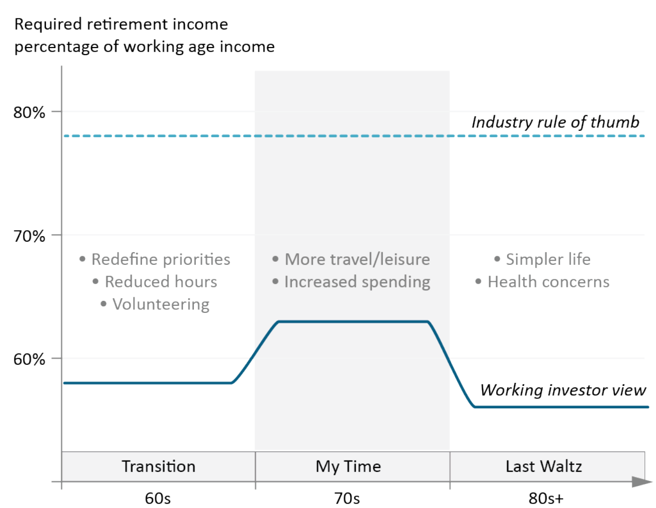
At the root are the cyclical and structural events in financial markets over the past 15 years, and the sweeping demographic changes. Unprecedented portfolio losses during the financial crisis re-defined risk as avoiding portfolio losses rather than enhancing return or financial gain through high-risk speculative investment. The searing experience of the financial crisis has caused investors to hold higher levels of liquid assets than ever before. Further, the sluggish recovery of U.S. equity markets until the last couple of years, and the prevailing low rates of interest, has reinforced focus on cash and liquidity and reduced confidence in investing for the long-term. Surveys of U.S. investors indicate that, on average, one-quarter of financial portfolios are in cash (with a similar trend evident in Canada), and for 25% of investors surveyed, the long-term is defined as less than five years.

Moreover, as markets have returned to greater normalcy, investors have not reverted to normalcy. Finally, the ageing baby-boom generation has increased emphasis on non-financial personal life objectives, with corresponding less focus on financial goals. The objective of the financial plan is to have sufficient financial resources to achieve the desired retirement, provide long-term care to an ageing parent, fund higher education for children and grandchildren, and meet philanthropic objectives, etc.

Retirement Goals Becoming Increasingly Complex

Not only have investors increasingly focused on meeting life goals rather than financial portfolio performance, but the key goals have themselves become more complex. For example, retirement was about accumulating sufficient savings to have the income to fund the relatively short period between formal retirement and death. But Paula Polito, Chief Strategy Officer at UBS Wealth Management Americas, described modern retirement as a three-phase process. First is the "transition" from the identity job, a gradual shift or phasing out of the full-time job to a succession of alternative revenue-earning options. This phase lasts 5 to 10 years. The second phase moves to a focus on leisure time, dubbed "my time", involving travel and family activities, and the third phase or "last waltz" is one of assisted and full-time care living. These extended phases of retirement can last 30 years or more, and have complex implications for adequate retirement savings.

Three Phases of Retirement



Source: UBS Investor Watch, IIAC

Adapting to the Changing Client Mindset

This investor questioning of the fundamental tenets of investing, and the complexities of retirement decisions have forced advisors to adapt to the changing psychology and the related client demands and preferences. First, wealth management firms and their advisors recognize the need to build strong relationships with their clients, and deliver financial services on a more holistic basis. They must then take a coordinating role at the centre of the client's financial decision-making. This approach enables advisors to develop a plan that includes tailored financial and estate planning, with the right tactics to meet their goals, and a personalized communication plan to keep the client informed of ongoing progress. Previous conferences have indicated that these deeper relationships across generations of the family build trust, facilitate better planning and lead to increased business, as assets are consolidated, and good service is rewarded with increased client business, client loyalty and client referrals.

Dealers need to understand these new challenges and find effective solutions. One challenge is to understand the information overload placed on clients and advisors, and the need to prioritize and manage this information flow. The importance of interpreting and explaining relevant information, particularly in the context of the financial strategy is critical. Second, advisors need to work hard at staying relevant to clients and their objectives, particularly as clients focus less on financial performance and more on success in meeting their life goals. Clients will ask themselves "How has the advisor done in making my life better?" In an effort to provide a clear and positive answer, advisors must spend more time on client priorities, speak the language of the client to encourage effective dialogue, and maintain a constant focus on aligning with the client's value proposition.

Motivation and passion are important ingredients in building a strong relationship. In this regard, some firms have found it helpful for advisors to ask the question "why" they are in the business of providing advice. Advisors must go beyond the pure financial equation, and recognize that delivering good advice is a key to making their clients' lives better. If clients are convinced of this proposition, the advisor-client relationship will deepen.

Keeping Abreast of Regulatory Change

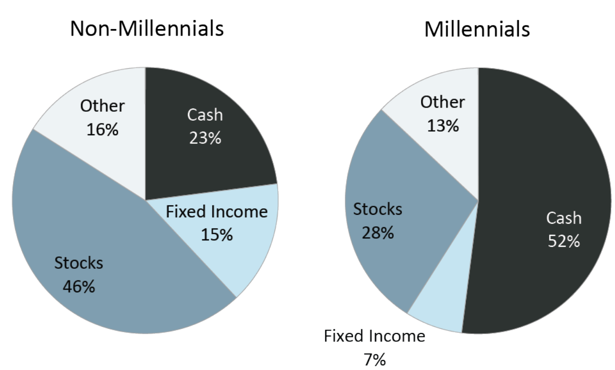
The torrent of new rules and regulations has added to the complexities of managing the advisor-client relationship. Supervisors and firms need to keep abreast of regulatory trends and, in particular, keep advisors well informed of new policies and procedures to comply with new regulations. For example, the demand for greater mobility and more frequent client communication through social media imposes a challenge to firms to ensure communication through media channels is properly monitored and in compliance with regulatory requirements.

Not Just Boomers: Millennials and GenXers

At the same time, firms must deal with demographic change, with an increased number of baby-boomers retired or approaching retirement, and living much longer and more complex retirement lives. This demands sophisticated financial and estate planning techniques and tax expertise. Firms and advisors must also increase focus on delivering financial services to the up-and-coming generations, the GenXers and the Millennials. These younger generations have not received the attention deserved from the industry, largely based on the misguided assumption this group has limited pools of wealth. On the contrary, many in this younger generation cohort have accumulated significant wealth and many will be the recipients of wealth transfer from their parents, although the estimate amounts may be less than expected given escalating needs as lifespans increase.

The challenge for advisors and their firms is to build relationships with this group, a group fundamentally different from the baby boomer generation. They exhibit greater skepticism of the financial business, having experienced the recent financial crisis first-hand and the subsequent well-publicized scandals, a surprisingly conservative attitude to the markets (half the assets of the Millennials is in cash), higher expectations of service and different channels of communications. Firms have met the challenge in several ways, including hiring young people onto broker teams, and moving steadily into social media. One way advisors are looking to strengthen the value proposition is to facilitate more "mobile" communication, both timely access to client accounts as well as more frequent contact. Clients, especially the Millennials, seek 24/7 access, typically through social media.

Higher Cash Allocation Among Younger Investors



Source: UBS Investor Watch

Maintaining Continuity as Advisors Retire

The second demographic change impacting the wealth management business is the ageing of advisors. The retrenchment and retirement of ageing advisors have coincided with the consolidation of assets across the industry, increased demand for specialized products and services, firms' exposure to loss of accounts and client assets reflecting increased incidence of life-changing events such as spousal death that provokes a change in advisor.

This generational transition of advisor must be handled carefully at firms, to retain and build client assets under management. Firms have engaged in various strategies. Ageing advisors are encouraged to establish partnerships and work in broker teams, requiring careful implementation of compensation arrangements. Many firms have built in-house training programs and developed internship programs, moving younger advisors through a succession of different positions within the firm, from compliance to financial planning operations.

Conclusion: Setting the Tone at the Top

Adjusting to changing client attitudes, changing regulations, changing client demographics and an ageing advisor force requires leadership at the top. The most important change for firms to achieve is one of culture, including a commitment to putting the client first and an ability to convince clients of this. Client priority means advisors and firms must align their services to the value proposition of their clients. Advisors must understand their clients' goals, define a clear plan to achieve them, and monitor progress. This requires in-house or out-sourced resources to provide expertise on a wide range of client life goals including retirement savings objectives, long-term care and advice on charitable gifting. Advisors and firms must also be fully transparent regarding the services provided and their fees.

The firm's senior management must frame and articulate its goals, and provide the resources to meet them. The firm's values and culture are set at the top of the house – and the leadership must demonstrate commitment to its objectives to ensure they permeate the entire firm and reach its clients.

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Yours sincerely,

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