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LETTER FROM THE PRESIDENT

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The evolving new paradigm for financial advice
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HIGHLIGHTS:

Retail business has reached a critical juncture. Clients now place priority on value and convenience to complement investment performance.

Advisors are more focused on the "why" i.e. the value proposition of the advisor, than on the "what" i.e. the investment process. Financial results translate to life objectives such as financial security, support for the extended family, leaving a legacy, etc.

Cost-effective passive or index-linked products, convenience in the delivery of financial advice and multi-faceted digital communication are keys to meeting the needs of investors.

THE U.S. RETAIL FIRMS AT INFLECTION POINT

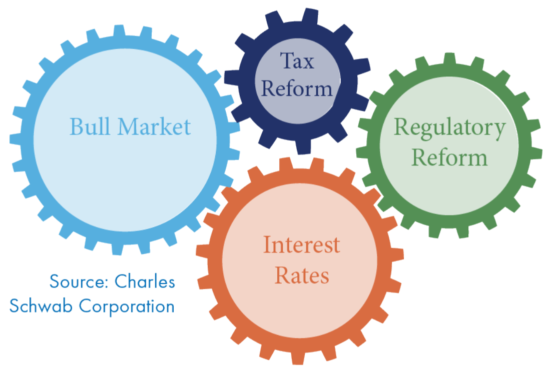
In early April, I attended the annual SIFMA Private Client Conference in Phoenix. The purpose of this President's Letter is to draw some general observations from the various presentations and panel discussions on the key trends in the U.S. financial advisory business, from the perspectives of the investor, and from the advisor and firm.

As the conference title "Financial advice in a rapidly changing environment" suggests, financial advice delivery now finds itself in the midst of rapidly changing retail financial markets, not so much from the impulse of regulation (although the U.S. Department of Labor fiduciary standard still haunts the retail world and FINRA has become a more pro-active regulator), but from the demands of an increasingly sophisticated and tech savvy investor, and intense competition to deliver client offerings from large and small firms across the industry. Client assets under management are more fluid than ever before, reflecting eroding brand loyalty, the tendency for financial assets to unmoor from advisors and firms by the actions of a surviving spouse and the inter-generational transfer of wealth.

The general assessment of the conference participants is that the industry is now at a critical juncture. One had previously thought the inflection point for the U.S. industry occurred in the immediate aftermath of the 2008 financial crisis when the industry was forced to rebuild client trust from rock-bottom levels—the ashes of Bear Stearns and Lehman; the bailouts for Wachovia and Washington Mutual; new portfolio alignments and shifting objectives in response to changing demographics; the ageing baby boomer; and the need to adapt to emerging new technologies in the business.

So why now a new inflection point?

An Inflection Point for Financial Services



Source: Charles Schwab Corporation

FOCUS ON LIFE GOALS AND CLIENT VALUE DELIVERED ON COST-EFFECTIVE TERMS

In recent years, the client priority has shifted heavily to emphasizing life goals and objectives – such as, financial security, health care needs of the client and extended family, leaving the appropriate legacy to families and communities, etc. This value to people's lives also responds to strong emotions, relieving anxiety and stress, and giving hope. It is a natural shift for the baby boomers getting close to retirement or in retirement. The investment process is of course still vitally important, but the emphasis is more on the distribution of assets to meet objectives and less on asset accumulation. More and more, the client seeks an advisor as a confidant or financial quarterback, and looks to establish a deeper relationship with the advisor.

Clients increasingly expect their advisor to guide them through the decision-making required to land on the right life objectives, with as much detail and granularity as needed. The detail of what constitutes financial security, health care or leaving a legacy to family or community varies considerably from client to client, managing expectations and taking account of differing circumstances and priorities. Moreover, these life objectives are continually in the process of change.

The successful advisor will be able to articulate the value proposition to the client. This is best explained by answering the important question – why is the advisor engaged? Why does the advisor work collaboratively with the client to meet life objectives? The second most important question is the how, and that is explained in the context of a detailed financial plan drawn up by the advisor and client.

Some presenters at the conference noted that it may be difficult for advisors and firms to make this convergence to a highly personalized and deeper client relationship. It requires special training, wide industry knowledge, and adopting new forms of client communication. Moreover, client trust is critical to build these deep relationships.

Achieving success in meeting end-objectives, and increasing confidence that success can be achieved, begins with advisors and clients agreeing on the right metrics to monitor success. These metrics include factors such as portfolio performance, fulsome communication between advisor and client, listening carefully to the client and reliance on a detailed financial plan to link the investment process and savings, as well as risk management, to financial and life objectives over a defined time horizon.

In addition to the importance of setting broad objectives, clients have become more value-conscious in recent years, reflecting increased awareness that complexity and high fees for investment products don't necessarily translate into investment performance. Investors certainly want to meet their objectives, but they want those objectives met on cost-effective terms. This means significant investment in low-cost passively managed investment products, such as beta and smart beta mutual funds and ETFs, and explaining the investment process in straightforward and easily understandable terms.

3.64

Number of connected devices that a typical digital consumer owns

Source: Charles Schwab Corporation

Moreover, clients expect a deep shelf of financial services, recognizing ancillary services like tax expertise, and financial and estate planning, can make a significant difference to portfolio performance and end results. They also want the investment process explained in simple and understandable terms. And they want the convenience in the delivery of financial advice, financial statements, and opportunities to engage in self-directed trading and online investing, from the client office or home. Finally, the client expects "high touch" communication with the financial advisor, virtually day-to-day, to understand progress in meeting objectives and identifying changes in the objectives, accessing financial results.

Finally, computing power, particularly digital technology, has provided the means through the internet and websites for advisors and clients to communicate on a real-time basis and encompassing all locations. This technology has transformed the relationship between advisor and client, giving the advisor the potential to move seamlessly and effectively to the centre of the client's financial life.

11+

Average hours per day that Americans spend consuming content on electronic devices

Source: Charles Schwab Corporation

This client emphasis on value and cost-conscious investing explains why Schwab and Fidelity were ranked one and two in a ranking of full-service U.S. retail firms in the latest J.D. Power Survey. These two firms have their beginnings as firms focused on the value-conscious mass market, and have expanded to build a full-service dealer–catering to wealthier clientele, but maintaining the principles of value and good service–reliant on technology. These characteristics resonate with clients.

THE ESSENTIAL ROLE OF DIGITAL COMMUNICATION

Advisors and firms will rely on digital technology to facilitate client communication, particularly in an era of frequent, virtual day-to-day, advisor-client contact. The end objective is to achieve "high touch" communication with the client. The advisor should be able to reach out frequently and at strategically important times to the client, to update through routine discussions and to react to special client "life moments", including marriages, births, children off to college, illnesses, etc. By the same token, the client needs convenient access to the advisor. The industry is making use of most forms of digital communication: social media, website and email. Social media is an excellent channel to identify and track the special events of the client, particularly Facebook or LinkedIn. Websites are important to attract new clients, and explain the offering of products and services. These sites need to be easily "findable" on the internet and LinkedIn website, and need to be clear and concise sources of information. Finally, texting has proven to be an effective digital communication vehicle – statistics show that responses to text messages take an average 90 seconds versus 90 minutes for responses to email. The problem, however, is that, now, texting is prohibited under securities regulations because the record cannot be retained permanently.

THE INDUSTRY WILL DO THINGS DIFFERENTLY

First, client demands for assistance in setting objectives and delivering on these objectives in cost-effective and convenient terms will drive change in the wealth management business. It is rapidly shifting the delivery of financial advice into a day-to-day proposition, a process increasingly facilitated through technology. Since clients are more focused on broad objectives, as a starting point, advisors must articulate the value they create in client's lives. This will require advisors to orient to a more relationship-based approach. For many advisors, this means more client-facing time and greater delegation of administrative tasks. This shift in business focus will not be easy in an environment of intrusive and prescriptive regulation.

Second, the demand for value and convenience is driving the search for more innovative products and services. For example, passively managed beta and smart beta investments will be sought out, as well as lower priced fee-based accounts, and focus on alternative investments with sufficiently high performance to justify the fees. Advisors and firms will meet client demand for greater transparency in the detail of investment products, and related fees and charges – assisted in the Canadian context by the newly implemented CRM2. Firms will also put in place ever more sophisticated technology to deliver advice, financial statements, etc., on a timely basis to the client's location, as opposed to at the firm office for an in-person meeting, and to harness client data to strengthen communications and adapt digital technology to improve frequency of client "touch".

Finally, firms will have to attract a new generation of financial advisors to transition from the ageing advisor, average age of 56, to meet the growing client diversity in terms of gender and background, to adapt to the expanding millennial client base, and to improve the productivity in delivery of financial advice. Firms will need sophisticated recruitment vehicles, sound training programs and effective transition mechanisms. The days of "cold calling" are long over, with mentorship and client sharing through teams the way of the future.

CONCLUSION

More sophisticated investing clients, less brand loyalty, the search for deeper advisor-client relationships, and differing client demands for financial and life outcomes juxtaposed against similar demand for value, service and convenience, have collided with an expanding array of financial products and services, and more sophisticated application of technology for online investing, delivery of financial services, and digital communication alternatives.

The foregoing investing trends, overlaid with eroding brand loyalty and the fluidity of client assets, has thrown the U.S. wealth management industry into the cauldron of structural change and shakeout, not dissimilar to the structural adjustments that flowed from the institutional collapse in the 2008-09 financial crash. The winners and losers from recent widespread change will be determined less by the impact of scale – between the wire-houses and independent firms, and more by those firms that adopt effectively to the evolving demands of the still-dominant and wealthy baby boomers and growing market influence of the millennials.

Yours sincerely,

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