

CHALLENGES AND OPPORTUNITIES IN 2010

Last year at this time, just one issue dominated the advisor's day: the economy driving the equities market into a rapid downward spiral, severely impacting portfolios and challenging advisors in ways that they had not been tested in the past.

This year, evidence abounds that advisors met the challenge of the disastrous 2008-09 economy and in 2010 have emerged with stronger, more focused businesses than before.

Working long hours was key, especially in order to communicate with clients. The amount of time invested in client interaction rose dramatically. In an October 2009 study, about two-thirds of advisors reported that they had spent more than 15 hours a week communicating or meeting with clients during the crisis. About one-fourth had put in more time, above 24 hours a week, contacting and talking with clients.¹

Flexibility, the willingness to adapt and re-think the way they managed their business, was another reason advisors were successful. In the Financial Planning Association (FPA) study, about 40% of respondents said that they changed communication plans, re-evaluated and changed the practice's investment philosophy and process, and altered client risk assessments.

For many advisors, the ability to manage their business well during the past 18 months was a boost to their confidence. About 44% of those responding to the study said that they were "more confident now than before the crisis."

And 58% said that they gained clients during the past year. So despite the myriad of challenging, ongoing economic issues financial advisors have reason to believe that they were able to prove their value to clients.

Looking ahead, advisors face new challenges, most of which are nothing like those that have been dealt with in the recent past. Here we identify challenges for 2010 – and the opportunities we believe that the challenges are creating.

Managing Portfolios and Risk

Despite the positive client gains reported by the FPA study, there is some reason to believe that clients stayed on because they valued stability during the financial crisis. But now that the crisis has passed, or at least abated, some wealthy investors will be reassessing their situations. According to Cerulli Associates², about 60% of wealthy households (with \$10 million to invest) had two or more financial advisors in June 2009. This is up from about 40% the prior August, and satisfaction percentages dropped over the same time period. Using more than one advisor creates a basis for comparison and advisors should be aware of possible client losses for that reason, Cerulli says.

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All the more motive to be proactive. Now is the time to be prepared to adjust portfolio management, and it is essential to recognize and respond to the fact that client risk perceptions have changed dramatically.

Portfolio Management

A look at Standard and Poor's 500 Index for the past year tells the story of a V-recovery in the market. There is virtually no shallow bottom on the chart to represent a period for leisurely decision-making. So now many investors are regretting that they missed

the market recovery that started in March 2009.

Managing portfolios in this atmosphere calls for a solid blend of understanding investor behavior and an investment roadmap that fits today's market.

Exchange-Traded Funds' (ETFs) continued rapid growth and expansion is a major tool for advisors and their clients. ETFs made up approximately 30% of equity trading volume in June 2009, up from 7% in 2004.³ Low cost has always been a major attraction of ETFs, but the increasing number of investment options gives the advisor more ways to design client portfolios. Beyond the early passive ETFs, investors can diversify with

actively managed long and short ETFs, along with dedicated sector funds. In addition, ETFs' strong market presence means that many clients recognize the concept and are more prepared to make the move into ETF investments.

Consider also an old favorite, dollar cost averaging, as appropriate for today's market and conservative investor mindset. As you talk with clients and understand their ability to withstand possible losses, “feathering” assets into equities over time reduces the risks associated with market timing and can help avoid the dissonance (regret) that can occur when moving 100% into stocks in one short time period.

As an asset allocation tool, tactical investing also addresses investor psychology. By allocating a portion of the portfolio into short-term vehicles, investors can take advantage of short-term market swings, offsetting traditional long-term strategies with low volatility and low correlation.

Revisiting Risk

“How much can I win?” is not what advisors are hearing these days. Instead, clients are asking, “How much might I lose?” (Recognize any connection with behavioral finance concepts?)

Back when investors had a healthy appetite for risk, some advisors responded to the desire for large returns and over-exposed clients to higher-risk products. As investors turned conservative, they lost confidence in their advisors, one of the reasons that satisfaction with financial providers dropped by June 2009.⁴

Advisors are stepping up their attention to risk tolerance with clients, going way beyond just filling out a profile form. Now, more than ever, advisors are continuing to have very close and frequent dialogues with clients, conversations that focus on making sure portfolios reflect their financial wishes. Advisors are taking more time to review investment objectives and risk tolerance and aligning them with the portfolio.

One advantage for advisors is that expectations have been re-set. Just as people are taking less-expensive vacations and cooking at home more, they are not expecting that miraculous stock market gains will deliver financial rescue. Investors are not comparing themselves with neighbors who have hit a winner in the stock market. With this newer, more sober attitude, clients should be ready to listen to a more conservative plan.

Helping Clients Retire

Long anticipated, it is happening now. Baby boomers, born between 1946 and 1964, make up about one-fourth of the U.S. population. Regardless of the nature of your client base, your expertise in retirement planning and distribution can become even more valuable in the future.

There is no easy formula for helping prospective and current retirees meet their goals. Some individuals are playing catch up – going back to work, postponing retirement – as they recognize that assumptions they made in earlier years are not holding up.

Many others are more fortunate. They need help assessing their situations, and they want assurance, based on rational planning, that their lifestyle can be maintained regardless of economic conditions. The advisor's assignment is to develop a payout plan that fits both emotionally and economically.

A time-segmented distribution strategy, such as Investnet's PlanHorizon, can help meet both emotional and practical objectives. The strategy allows assets to be segmented and managed as separate portfolios that parallel to the different stages of retirement, adjusting for risk and income needs. This time-segmented approach makes intuitive sense to clients, laying the groundwork for a proposal to be accepted.

Wealthy or not-so-wealthy, boomers lost a lot of confidence during the market crash. They are looking for an advisor with knowledge, skill and leadership to help them lead full, happy lives as they age.

Regulation, Reform, Compliance, Disclosure = Challenge

Dealing with the financial meltdown does not stop with client issues. It is clear that 2010 will bring more rules and regulations, adding complexity to business operations.

Hot #1 topic is the fiduciary standard. For years, it has been clear that investors do not understand the differences between brokers and advisors, as most recently confirmed by the 2008 Rand Corp. study. People do not understand that brokers are sales agents for their firms, and as such do not owe clients a fiduciary duty at the level to which fee-paid advisors do. This issue has percolated for years, but episodes like the Madoff scheme created a stronger impetus to resolve the issue by bringing all participants under the same fiduciary umbrella.

Another change that advisors can count on is more disclosure regulation. Point-of-sale disclosure for mutual funds, elimination of 12(b)-1 fees, additional 401(k) plan fee disclosure and investment advice are under consideration by the SEC. Another result of the Madoff episode: tighter audit rules are being developed, especially for firms that custody their own securities or have relationships with their custodians.

Although the exact details for these regulatory issues are not yet been decided, it is clear that advisors will have more record-keeping and compliance to deal with in the future. As time demands for client communication increased during last year's economic crisis, the importance of efficient operations became even more evident.

Technology tools can help meet this challenge. Look for a platform that supports client relationships by 1) empowering advisors through their fiduciary process with investment oversight and enhanced reporting capabilities, 2) providing tools that maintain records for compliance and 3) even anticipating regulatory changes. This support can go a long way toward supporting an advisor's business objectives.

The Advisor's Best Tool: Communication

As noted earlier, last year's crisis spurred advisors to increase the time they devoted to client communications each week. And about half of the advisors in the FPA study enjoyed a net gain in their client base last year.

Additional results from the study showed that advisors are still devoting more time to directly contacting their clients than they were in late 2008, although the hours per week are down from their peak. The challenge now is to maintain this pace and strengthen relationships with communications that fit the needs of clients.

Some clients are hesitant to open up about issues that are



important to them, or they wait until a problem becomes an emergency. Advisors are finding creative ways to get the conversation flowing. One planner took the initiative to show his clients how to contest their real estate assessments.⁵ Many advisors are taking the lead in getting donations to Haitian earthquake victims.

Consider, too, the setting for meetings. A formal conference room would be a great fit for more reserved clients; others might be more open in an informal setting – a coffee shop or cafe, as long as privacy can be maintained.

The ripple effect of the recent market volatility has opened up new problems for clients, just as it has changed their risk

perceptions. This creates an opportunity for the advisor to do what he or she does best – help clients meet their goals and objectives, regardless of the economic climate. This is where the specialized knowledge and skill of a financial advisor can genuinely add value for his or her clients.

Looking Ahead

Yes, advisors are looking at a challenging year ahead. Portfolio decisions, balancing client expectations and increasing compliance and regulatory demands will demand an ability and willingness to adapt to changing conditions. And, at the same time, advisors must maintain the high level of client communication that is the core of their profession.

1 *A Year After the Market Crash: How Financial Planners are Adapting to a New World*, white paper developed by the FPA Research Center. Denver: Financial Planning Association, 2010.

2 "Clients May Shift Advisers as Markets Calm," Wall Street Journal, January 11, 2010 <http://blogs.wsj.com/financial-adviser/2010/01/11/clients-may-shift-advisers-as-markets-calm>.

3 Vanguard study cited in Equities magazine, October 2009, page 24.

4 "Clients May Shift Advisers as Markets Calm," Wall Street Journal, January 11, 2010 <http://blogs.wsj.com/financial-adviser/2010/01/11/clients-may-shift-advisers-as-markets-calm>.

5 "Adviser Helps Clients Reduce Property Tax," Wall Street Journal online, January 19, 2010 at <http://blogs.wsj.com/financial-adviser/2010/01/19/adviser-helps-clients-reduce-property-tax/>



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