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Six Alphas for Wealth Managers

How am I doing? As a wealth manager, that's a question you routinely field from your clients. But, how often do you look in the mirror and ask yourself the same question?

Whether your practice is mature or you're looking to expand, it's important to ask yourself how you add value for your clients—and how you should be judged. Yet, there's no ready performance metric for wealth managers. Of course, clients judge traditional money managers by their investment performance. Do they add alpha in excess of their cost? However, there's no simple polar question to gauge the value of a wealth manager. That's because you play two roles: the chief investment officer who manages investment portfolios, as well as the trusted advisor who serves as an objective resource on a range of other financial issues, from college funding and estate planning to family dynamics and business succession planning.

Therefore, determining how you add value requires blending quantitative and qualitative measures, says Glenn Frank, CFP,® CPA/ PFS, Director of Investment Tax Strategy at Lexington Wealth Management in Lexington, Massachusetts. In fact, Frank has done just that by identifying and delivering Six Alphas for Wealth Managers:

– **ASSET ALLOCATION** Accounting for almost 94% of the variance of total portfolio returns,[1] asset allocation is the bedrock of investment management. So, it almost goes without saying that your value begins by creating a broadly diversified portfolio. If this seems too basic a benefit to tout, think back to how many of your clients arrived at your door with "diversified" portfolios spread only across domestic equities or heavily overweighted to financial or technology stocks.

  You add value by evaluating a client's individual circumstances, biases and current market conditions and investing across asset classes—stocks (domestic, international, small, large, growth, value), bonds (domestic, international, high yield, municipal) and other assets (real estate, commodities, MLPs, hedge funds)—to create the diversified portfolio you believe can deliver best risk adjusted after-tax returns.

  Your diversified approach reduces the risk of a client being in an isolated asset class and experiencing a large loss that erodes the compounding of returns and is difficult to make up both mathematically—and emotionally.

– **MANAGER SELECTION & MONITORING** You provide additional value by selecting and monitoring the managers to capture each asset class. This involves conducting due diligence and measuring each asset class—US, international, bonds, alternatives, precious metals and real estate—against the appropriate benchmark.

  Notably, the industry standard benchmark your clients are most familiar with, the S&P 500® Index, is rarely a good match for their diversified portfolio. You can add value by educating clients about the need to measure the performance of their portfolio against the customized benchmarks (international, commodities, etc.) that you are actually using. This will provide a much more accurate view of your clients' performance. And your detailed performance reporting improves overall decision making. In addition to periodic rebalancing to capture gains as they occur across asset classes and keep the asset allocation mix you selected on track, you can add value by monitoring the managers you select, and replacing those who under perform.

– **GOAL TRACKING** Of course the ultimate performance measure is a personalized benchmark that gauges progress toward a client's short- and long-term financial goals. That is, although a portfolio might hit its target rate of return of 8%, a lost job or unexpected long-term health expenses might put a client's goals in jeopardy.

  Accordingly, you can add value by framing your client's progress in a personal way. That requires positioning a client's assets in relation to current and future liabilities, whether it's a large outlay of cash to fund college or to provide support for aging parents. You will also need to factor in a range of personal variables, including general health, job security and family circumstances.

  Broad conversations about work and family, even assets held away, can give you insight into what motivates your clients, helping you to perceive potential challenges and help them to stay committed to their plan.

  Hannah Shaw Grove's Whole Client Model (Figure 1), a comprehensive information-gathering tool, can help you surface clients' needs and deliver personal attention that goes well beyond managing their portfolios. By truly understanding your clients' relationships, values, and preferences, you have more opportunities to meet, and even exceed, your clients' expectations.

FIGURE 1: THE WHOLE CLIENT MODEL

Section	Purpose
Relationships	Identify relationships that are most important to the client and those that carry some financial or emotional obligation.
Financials	Identify all the client's assets and liabilities, including current sources of income and any factors that may impact them in the short-or intermediate-term, as well as the structure, registration and location of other financial assets.
Advisors	Identify other advisors that work with the client on a regular basis, including accountants, attorneys and business managers, and understand the role and the influence each has in the client's life.
Process	Identify the client's preferred method and frequency of interaction, and the level of detail required to satisfy the client's sophistication and curiosity.
Interests	Identify those activities and topics that occupy the client's time and money, including hobbies, religious, political, medical and philanthropic.
Goals	Identify the client's personal and professional goals, and their intentions for their family and loved ones.

Source: http://www.hsgrove.com/wholeclientmodel.html

– **AFTER-TAX RETURNS** Today's top capital gains rate of 20% and the 3.8% Medicare tax on net investment income for individuals with an adjusted gross income of $200,000 and couples with $250,000 make tax-aware investing more important than ever.

  You can add tax alpha for clients, without increasing portfolio risk, by implementing investment location, a strategic process that seeks to optimize after-tax returns by placing stocks, bonds and other assets—according to the specific nature and timing of taxes they generate—in either taxable or tax-deferred accounts. The income tax savings over time can be substantial, ranging from 10 to 30 basis points (an average of 20 basis points) a year when compared to simply equally dividing assets across taxable, tax deferred accounts and ROTH IRAs.[2] In cases where accounts currently are not located optimally from a tax perspective, you may be able to save clients the equivalent of your annual advisory fee. (Learn more in *How to Implement Investment Location to Generate Alpha*, available on spdru.com.)

  Tax-loss harvesting, the practice of selling investments that have lost value to offset current and future-year capital gains, can also benefits clients. By harvesting losses throughout the year, you take advantage of market dips to book valuable tax losses.

  When you sell a losing position, you can simultaneously purchase a similar security to maintain your exposure to the asset class in case it advances. For example, if you sell a US large cap equity mutual fund that's lost value, you could use the proceeds to buy an ETF that offers similar exposure—like the SPDR® S&P 500® ETF (SPY). ETFs, with their broad market coverage and complete transparency, are ideal for these "tax swaps" because they help you comply with the Internal Revenue's (IRS) Wash-Sale Rule that prohibits investors from claiming a loss on the sale of an investment and then purchasing the same or a substantially identical investment within 30 days before or after the sale date.

– **EMOTIONAL BUFFER** Studies show most individual investors, alternately fueled by greed and fear, fail to achieve market returns because they buy at market peaks and sell at low points.[3] As a wealth manager you add value by managing clients' expectations—and emotions.

  In the same way coaches train athletes to calmly execute the game plan, you counsel clients not to panic in a downturn and, equally important, not to become irrationally exuberant in a bull market.

  Create an investment policy statement that outlines clients' goals and your investment approach and guides your responses to the market. When the economy hits a rough patch, the investment policy statement helps clients to deal with their emotions and maintain their focus on the long-term.

  In all markets, providing the necessary context and support to help your clients synthesize relevant information and stay on course helps them to move confidently forward to reach their goals.

– **COMPREHENSIVE SERVICE** Above all else, your clients value knowing that you are a trusted advisor who acts with complete integrity, loyalty, and transparency and always puts their needs first.

  A holistic approach to planning and investing is the key to providing the comprehensive guidance clients want. That is, beyond working together with clients in an open partnership to meet their goals, you also work hand-in-hand with your clients' estate planning attorneys and other financial professionals to ensure the entire investment portfolio is structured in a way that best supports your clients' short-and long-term goals.

Your clients can also benefit from working with your expansive professional network, a talented team of trusted advisors who offer specific expertise and objective counsel when necessary.

Notably, new research from State Street Global Advisors and the Wharton School at the University of Pennsylvania, *Taking on the Role of Lead Advisor: A Model for Driving Assets, Growth and Retention* (available on spdru.com) emphasizes the value a "lead advisor," or personal chief financial officer offers clients. As a lead advisor, you can manage the interaction between financial professionals, aggregating the client's statements and account information, coordinating strategies, and providing the objective counsel necessary to build and maintain your clients' financial health through all market cycles and life events.

Reviewing Frank's six alphas underscores that your work as a wealth manager is multi-faceted. In managing your clients' assets, you deliver peace of mind and bring quantifiable and unquantifiable value to your clients.

Keep in mind, however, that clients' focus on goals like retirement with multi-decade long time horizons sometimes makes it difficult for them to readily identify all the current value you bring to the relationship. Accordingly, it's periodically worth offering concrete descriptions of the recent services you have provided, for example, investing to more closely fit their risk tolerance, integrating multiple accounts to guard against portfolio overlap, or re-positioning their portfolio to take advantage of emerging market opportunities.

Discussing Fees with Clients: Emphasizing Services Instead of Stressing Value (available on spdru.com) explores how communicating your value in a tangible way to maintain productive, trusting, long-term relationships with clients. Actively conveying a fair balance between the specific services you provide and the fees you charge is much more meaningful than simply telling your clients that you provide value. For example, discussing tax savings or risks avoided rather than big picture "financial security" creates a service/fee balance for clients and helps them to define your value for themselves.

Whether meeting with a prospect or long-time client, Frank's six sources of alpha can serve as touchstones to help you understand—and communicate—the many specific ways you add value. Further, evaluating your performance on a regular basis, complete with clients' feedback, can ensure you continue to do all you can to help your clients achieve their goals. And, because successful clients tend to be engaged and loyal clients, delivering on these six alphas can add alpha to your practice as well.

ABOUT GLENN FRANK

Glenn Frank, CFP,® CPA/PFS is the director of investment tax strategy for Lexington Wealth Management in Lexington, Mass., where he develops customized financial and investment related tax strategies for clients and contributes to the overall investment decisions of the firm.

With more than 20 years of experience in investment consulting and financial planning, Glenn was recognized by *Worth* magazine as one of the country's Top Wealth Advisors for 10 years in a row. He is the Founding Director of the Master of the Personal Financial Planning program at Bentley University, a member of the program's advisory board and teaches two graduate level courses in the program. Glenn received his MBA from West Virginia University, graduating with high honors, and a Master of Science in Taxation (MST) from Bentley University, graduating with high distinction.

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[1] Brinson, Beebower et al entitled "Determinants of Portfolio Performance" (1986) and "Determinants of Portfolio Performance II: An Update" (1991)
[2] http://www.irebal.com/docs/AssetLocation.pdf
[3] http://www.moneynews.com/InvestingAnalysis/Dalbar-Harvey-individual-investors/2013/03/11/id/494045

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