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In a World of Fee Compression, Avoid the Race to the Bottom

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It is evident that fee compression is an escalating trend in most global industries. Much of this is due to advances in technology, replacing certain human elements and the cost associated with "man hours". In some cases, this automation can be a direct benefit to consumers where the associated cost savings are passed on. In other cases, the end result can be inferior service, or improved margins for businesses, rather than benefitting customers.

This takes me back to my 15-year-old self, sitting in my Business Studies and Economics class – *you either compete on quality or cost*. **It's time to show your quality through high level thinking to bring in those High Net Worth clients.**

History has shown us giants of the game at either end of this spectrum, from a low-cost juggernaut such as Sam's Club, to a luxury retailer such as Rolex. The wealth management space is no different. With pressure to compete on price, the **race to the bottom** is rampant in modern wealth management.

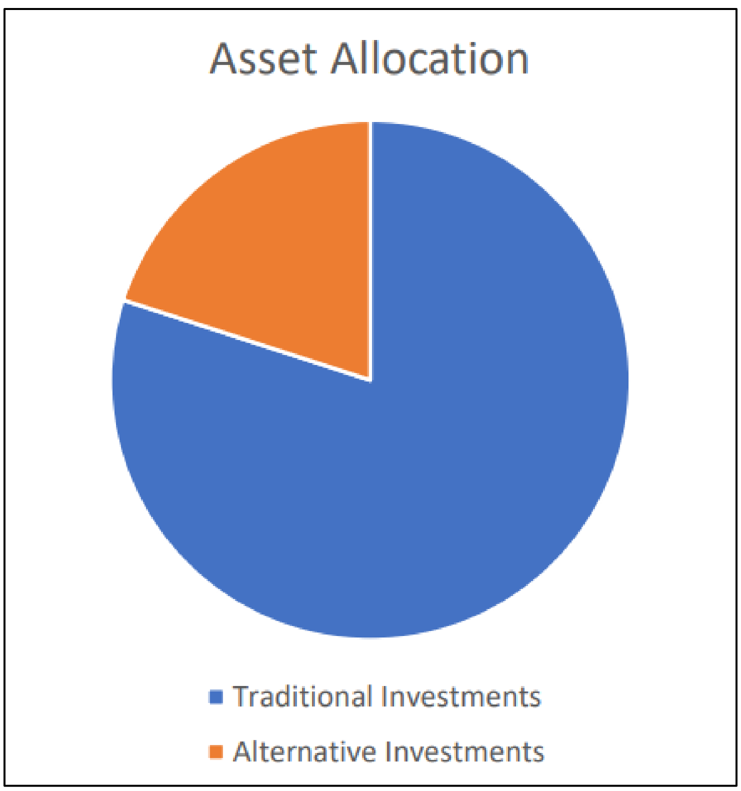
We have seen Schwab, TD and Fidelity eliminate commissions on online trading. It would be impossible to see how any of their competitors can buck this trend without being wiped out. A.T. Kearney estimate the robo industry managed roughly $30 billion in 2017 and is expected to top $2 trillion this year. We know that the low cost robo options can be priced *less than a third* of a full-service advisor fee. What a tragedy this is!

There are various ways an independent advisor can maintain the quality and level of service without reducing their fee. I have heard the phrase "a robo advisor won't come to your kid's birthday party". This certainly sums up the service and personal relationship element in a practice. Clients are willing to pay for a more personalized service and someone they can always call when they are concerned. This is even more true in tougher market conditions and when there is a life event such as a birth, inheritance etc.

Performance is clearly important in the world of wealth management. Relationships and service are equally important. I pay additional fees to be able to speak directly to a person at my bank or credit card rather than plod through an automated system. I would give up my first born to avoid the torture of an automated system when dealing with my cable and Wi-Fi company. Nausea sets in when I am connected to an overseas call center. I long for the good ole days when you could sit down with your bank manager and talk about a business loan or mortgage, receiving personal service rather than an algorithmic response.

I am not devaluing the impact of great client relationships and the personal service; however, it is not the crux of this discussion piece. Today, I want to talk about justifying your fee by focusing on what can differentiate you from competitors through your product offering.

Let's use the theoretical 80/20 split here for the purposes of this discussion. 80% of an HNW accredited investor portfolio in traditional allocation vs. (up to) 20% in alternatives. (I am not referring to the 60/40 stocks/bonds portfolio here. That split would be addressed within the 80% traditional investments in the pie chart below.)



80% Traditional Investments

Equities, bonds, cash

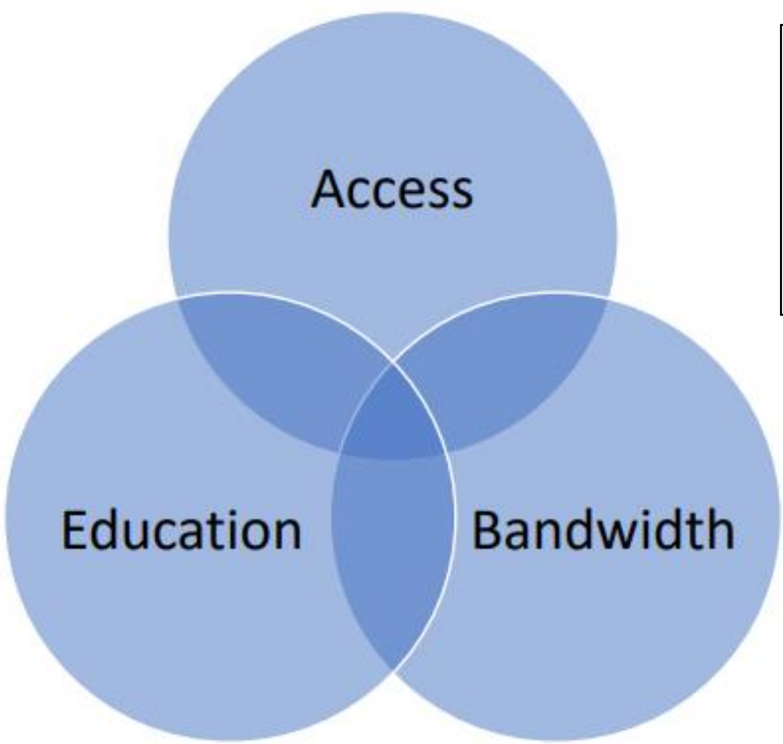
20% Alternative Investments

Something other than a stock, bond or cash e.g. real estate, private equity, oil and gas interests etc. *Up to 20% allocation to alternatives depending on the risk tolerance, sophistication, and size of the client portfolio.*

Unless an advisor displays Bobby Axelrod stellar levels of performance with his/her mainstream parts of the portfolio, it is very hard to differentiate here. The difference in performance between an average asset manager and an exceptional asset manager, when limited to traditional assets classes is marginal at best. The difference between average and exceptional when using more complex structures and alternative investments takes us into **“multiples of”** territory.

Time for an NFL analogy here. Back in the day, some coaches would call all of the plays on both sides of the ball; act as head coach; and act as General Manager. In fact, the legendary Bill Belichick still holds that HC/GM hybrid role. It is unthinkable nowadays for a Head Coach to do everything. If he is not surrounded by a great GM, offensive coordinator, defensive coordinator, special teams coordinator and the plethora of data analysts and position coaches he will fail. The modern Head Coach does not do any of the jobs himself, he holds everything together. In financial terms, he is the *strategic overlay*.

An advisor with confidence delegates like a Head Coach would. There must be trusted partners with individual expertise and outsourced solutions working alongside the advisor. The outsourced investment manager may never have met the client and is working to a remit set out by the advisor. The advisor has the detailed knowledge of the client’s circumstances and valued relationship with the client and must manage the overall investment process and relationship.



To succeed in using alternatives, you need 3 critical elements to align:

- Access to quality investments
- Education for yourself and for your clients
- Bandwidth

Here is why the 20% is often neglected by advisors:

- For many advisors, alternatives are outside their comfort zone and are intimidating
- It is difficult to manage bandwidth to allocate the required time to this part of the portfolio
- Access to quality alternative solutions is sometimes difficult and it is a complicated space with a plethora of options

Here is how to capitalize on this opportunity:

- Challenge yourself and step outside of your comfort zone. In doing so, you are already in the minority and have a competitive edge. Educate yourself and your clients around alternative investments.
- Delegate within your team or use an OCIO solution to free up your time to focus on alternative investments. Due to fee compression, such solutions are much more affordable than they have been historically. You are probably already wearing the hats of business development director, portfolio manager and relationship manager. Share the load so you are not stretched too thin.
- Don't add a fourth hat to that mix, that of investment banker. Partner up with a trusted third party to help you navigate the alternative space and help you find the right solutions for your clients.

In a world of fee compression, **be the disruptor and buck the trend**. When everyone is following the herd and slashing their prices, this is your opportunity to make a stand:

- Avoid being the Jack of All Trades, Master of None
- Show value no other advisor can by differentiating yourself in the areas where they cannot
- Attract the higher net worth clients with your improved offering and high-level thinking
- Surround yourself with experts and trusted partners
- Be the Head Coach and race to the Superbowl

These are your first steps in avoiding the race to the bottom!

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Hillson Consulting is a boutique investment consultancy founded by financial services entrepreneur Richard Hillson. The company helps independent advisors enhance and improve their offerings and drive revenue through alternative investments. We empower you to differentiate from competitors through our three pillars approach: education, access and bandwidth support.