

The
**PERFORMANCE
PARADOX**

Overcoming present day
misalignments and
delivering on investors'
long-term goals

Executive Summary

Financial advisors are questioning their value propositions. They want their clients to reach long-term financial goals and objectives.

Yet, advisors find themselves caught in a **performance paradox**. Despite their best intentions, many advisors have been justifying their worth based on market and investment product returns in the short term rather than performance that is personal to the client over the long term.

Ultimately, an advisor's value is judged by his or her clients. So ...

What do investors value?

Investors value performance. They say it is the number one capability they want from their investor provider. They also say it is their investment provider's number one weakness.

But what exactly is performance?

Performance isn't just about returns. In fact, short-term returns-chasing and behavioral biases are key reasons why investors perform so poorly and fail to reach their goals.

It doesn't have to be this way. By using a goals-based wealth management approach, advisors can redefine their value propositions and deliver performance that is personal.

There are skeptics who believe goals-based wealth management is already being delivered and that change is not necessary.

We disagree.

Investors, advisors and organizations can change, will change and are already changing. To complete this transformation, they must overcome "the three Cs" of misalignment.

Clients are Conflicted: Investors' actions, behaviors and even measurements of success conflict with their efforts to reach long-term goals.

Advisors are Constrained: Advisors are constrained by investors' narrow and unrealistic expectations. They aren't having the right kinds of conversations and they often aren't seeing investors' full financial pictures.

Organizations are Cautious: Making big investments in the infrastructure and technology necessary to support goals-based wealth management feels like a risky proposition to many organizations.

Yet, a state of better alignment is not only possible but necessary, and beneficial to all three groups. Advisors and organizations must:

1. **Manage clients holistically**
2. **Manage wealth holistically**
3. **Elevate industry standards**

Based on 30 in-depth interviews with executives, advisors and industry thought leaders, and surveys of 288 investment professionals, we catalogued the best practices that are helping them overcome misalignments. We identified 34 specific tactics as a result of their collective recommendations.

By embracing goals-based wealth management, personal performance and the recommendations outlined in this paper, advisors and organizations can overcome the performance paradox and broaden their value propositions.

The Performance Paradox: Overcoming Present Day Misalignments and Delivering on Investor's Long-Term Goals

October 2015

Over the past 40 years, with the objective of helping investors grow their portfolios, the financial services industry has largely concentrated on accumulation strategies and individual products. The unintended consequence has been a focus on short-term returns rather than long-term outcomes. As a result, financial organizations, their advisors and end clients have found themselves facing a “performance paradox.” In this paper, we examine that phenomenon and the industry's response.

For several years now, some industry experts have been predicting a fundamental sea change in the delivery of retail financial advice with the next phase focusing on helping clients to achieve their individual lifetime goals by effectively coordinating the multiple accounts and products found in the typical investor household. It is now increasingly evident that those predictions are coming true.

The Money Management Institute (MMI) and its member firms have been at the forefront of the evolving industry dialog around this concept — which has been variously labeled as Household, Outcome-Based, Coordinated Account and now Goals-Based Wealth Management. As an organization, we have sought to promote thought leadership, share best practices and impart lessons learned by early adopters of the goals-based framework.

For our second white paper on this important topic, we are pleased to partner with the State Street Center for Applied Research (CAR). Its papers on *The Influential Investor: How Investor Behavior is Redefining Performance* (2012) and *The Folklore of Finance: How Beliefs and Behaviors Sabotage Success in the Investment Management Industry* (2014) explore the notion of “personal performance,” which is integral to a goals-based approach. CAR's research-based methodology provides an alternative lens through which to examine the challenges faced by financial organizations, advisors and investors.

For goals-based wealth management to move from an aspirational state to a reality, our industry must take proactive steps to address existing misalignments. The effort is well under way with many of the largest firms now making or contemplating significant investments in systems that tie together and coordinate the elements of a true goals-based approach.

This paper presents recommendations and suggested tactics to help firms and advisors create the ecosystem necessary to implement goals-based wealth management, deliver personalized performance and escape the performance paradox — thus helping clients to better achieve their lifetime and financial goals.

CRAIG D. PFEIFFER
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Financial advisors are questioning their value propositions. They want their clients to reach their financial goals. This is a key part of their mission.

Yet, advisors find themselves caught in a **performance paradox**. Despite their best intentions, many advisors have been justifying their worth based on market and investment product returns in the short term rather than performance that is personal to the client over the long term. This paradox serves to undervalue the true benefits of financial advice and leaves advisors exposed to client dissatisfaction and attrition. Most worrying, it puts clients at risk of falling short of their original and ultimate objectives of reaching their financial and life goals.

How can advisors expand their value beyond today's definition of performance?

This isn't the first time value propositions have been called into question.

History shows a number of major shifts in the provision of financial services and advice. Until well into the 1970s, most individual investors kept the majority of their assets in banks. They saw the value of investments as primarily an area in which to speculate with leftover funds. As markets started to significantly appreciate, financial products proliferated in the 1980s. Investors, through brokers, were able to access a wider range of product choices. They began to participate more broadly in markets, redefining value as an opportunity to grow their wealth. More recently, as wealth management has become more complex and products more sophisticated, investors are demanding a broader range of wealth-management services, spurring a shift from the “broker” to the “advisor” moniker. Investors are also looking for more personalization. All these shifts are fueling the proliferation of separately managed accounts and, ultimately, the advancement of advisory solutions.

After a 25-year tailwind in equities and fixed income, from the early 1980s to 2007, investors have come to expect a certain level of returns; the 24-hour news cycle added fuel to the fire by encouraging investors to expect their advisors to deliver returns in the short term as well. Yet, market realities in the wake of the financial crisis and ongoing market volatility have made this a challenge and redefined a new “normal.” Advisors and organizations today face the need to manage clients' expectations and behaviors while providing them with ever more personalized advice and customized solutions.

What do clients want ... and what are they getting?

Performance in Play



We asked investors which capabilities would become increasingly important to them over the next 10 years. Performance was their overwhelming choice; investors ranked it as the most important driver of value.¹

Then we asked the same group to identify investment providers' greatest weaknesses. Once again, performance was their top area of concern. Advisors weren't surprised. They told us that the number one reason clients leave them is due to underperformance.²

Performance is incredibly important to investors. But in order to escape the performance paradox and clarify their value propositions, advisors and organizations must know the answer to this basic question:

What exactly is performance?

Historically, many have viewed performance as being synonymous with investment returns. This is a problem. It is becoming increasingly difficult to consistently deliver superior investment returns.^{3,4,5} In addition, when investors focus solely on the returns element of performance, they achieve sub-optimal outcomes.⁶ Currently, only one out of five U.S. investors and 12 percent of investors globally believe they are wholly prepared to reach their goals.⁷

So, what's missing?

Advisors and organizations must look beyond returns. This means expanding their definition of performance by helping clients maintain a level of downside protection while preparing for liabilities and income needs. It means minimizing costs and taxes by efficiently locating assets in the optimal account type. It means having the courage to acknowledge that the current system is facilitating returns-chasing, which is hindering investors' ability to reach their long-term goals.

Now, more than ever before, advisors and organizations have an opportunity to escape the performance paradox. By using a goals-based wealth management (GBWM) approach, they can redefine their value propositions and deliver performance that is personal. While many goals-based wealth management elements we will describe in this paper are in place, leading organizations are now connecting the dots to help their advisors provide a more consistent and holistic level of advice that will allow advisors to both scale their practices and improve client and advisor outcomes simultaneously.

Yet, despite the endorsement of this concept by industry leaders, widespread implementation has been slow. One of the primary reasons why goals-based wealth management isn't being implemented more quickly is that it requires a transformational change to an organization's infrastructure in order to provide consistent and personal guidance on a large scale. Moreover, there are skeptics who believe goals-based wealth management is already being delivered, and that change is not necessary.

We disagree.

Clients, advisors and organizations can, and will, change. In fact, change is already under way. Leading organizations are making significant initial investments in the infrastructure and technology needed for investors to enjoy improved outcomes. But in order to complete this transformation, all three groups must overcome the three Cs: misalignments that hold them back.

“Of the top 100 advisors by assets under management and revenue in the United States, I’d estimate that 70% are moving toward a goals-based approach. And of those advisors who are growing their businesses most quickly, it’s nearly 100%.”

INFLUENTIAL EXECUTIVE AT A LEADING INDUSTRY PUBLICATION

The Three Cs



Clients are Conflicted

1. Distraction from long-term goals
2. Behavioral biases
3. Lack of knowledge about fees



Advisors are Constrained

1. Narrow definition of advisor skills
2. The wrong conversations
3. Limited view of client financial situations
4. The advisor’s toolbox lacks key tools and coordination



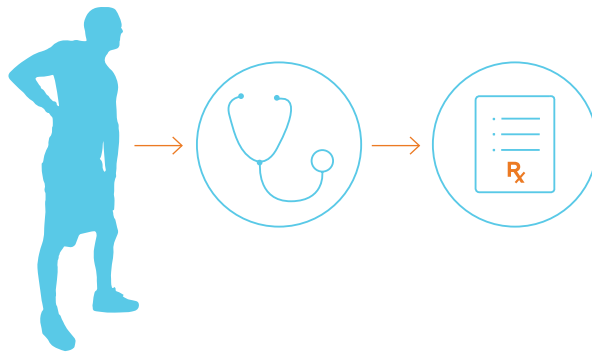
Organizations are Cautious

1. Change is hard
2. Change requires will and consensus
3. Financial incentives — perception matters



Clients are Conflicted

It's often useful to look at a problem from a different point of view. Let's identify the similarities between today's investor and another, seemingly unrelated individual: a patient who suffers from back pain.



It's been 15 years since the patient injured his back. Some days are better than others, but the routine is the same: pain pills in the morning, pain pills in the evening. He has forgotten what it feels like to live pain free. Every once in a while, he forgets to fill his prescription — he is in so much pain that he inevitably calls his doctor and leaves work early to go get his pills. At the end of each day, the patient is satisfied if he was able to make it through the day with only minor discomfort.

It's been 15 years since the investor opened his first IRA account. Some days are better than others, but the routine is the same:

watching his portfolio gain and lose value. He has forgotten what it feels like to live worry-free. Every once in a while, markets take a turn for the worse — he worries so much that he inevitably calls his advisor to make changes in his portfolio. At the end of each day, the client is satisfied if he was able to make it through the day, without experiencing losses in his portfolio.*

What do the patient and the client have in common?

They've forgotten to prioritize their original goals. On a day-to-day basis, the patient has lost track of his initial goal of getting well, and the investor has lost track of his initial goal of retiring comfortably.

Clients are distracted from the principal reason that they invested in the first place — to reach their financial and life goals. This is compounded by behavioral biases and a lack of understanding of the fees they pay.

Client misalignment #1 — Distraction from long-term goals

Eighty percent of U.S. investors and 73 percent of investors globally cite long-term goals as their primary reason for investing.⁸ This doesn't come as much of a surprise. What is surprising is that only 34 percent of U.S. investors and 29 percent of individual investors globally *define success* as reaching long-term goals.⁹ Instead, they rely on impossible or inappropriate metrics, such as making gains while never incurring losses. This creates a kind of

* Hypothetical example.

dissonance, where investors' actions become misaligned with their own needs.

Clients' failure to align their definition of success with their reasons for investing creates a set of investment behaviors that jeopardize successful long-term outcomes.

For example, when asked what steps they need to take over the next 10 years in order to be prepared for retirement, investors' top response (40 percent) was to become "more aggressive."¹⁰ However, looking at their asset allocations, we see that cash is their number one allocation. Globally, the average investor holds 40 percent of his or her portfolio in cash, while U.S. investors hold 36 percent of their portfolios in cash.¹¹

Notably, investors who work with advisors tend to hold less cash in their portfolios. Even so, advised investors in the U.S. as well as globally still hold 32 percent of their assets in cash.¹² This preference for cash is likely unsuitable for investors

with a long time horizon. It is clearly at odds with the desire to become more aggressive.

Client misalignment #2 — Behavioral biases

Behavioral biases are causing investors to act against their own best interests. At a very high level, investors lack self-awareness about their investing abilities. Nearly two-thirds of investors in the United States, and globally, consider their financial acumen to be "advanced."¹³ Yet, we found that actual financial literacy levels are discouragingly low. In our own financial literacy assessment of concepts such as diversification, inflation and knowledge of basic investment products, we found that the average global financial literacy score is just 61 percent — barely above a failing grade.¹⁴ This is a classic example of overconfidence,¹⁵ a well-documented behavioral bias.¹⁶

79%

When the question was framed in terms of gains, the majority preferred the certain outcome of winning \$80,000 than gambling on the chance to win \$100,000.²²

A 100% chance of winning 80,000 vs. an 80% chance of winning \$100,000 and a 20% chance of winning nothing.

However, when the conversation was framed as a loss, a majority were willing to take the gamble rather than lock in a certain loss.²³

A 100% chance of losing 80,000 vs. an 80% chance of losing \$100,000 and a 20% chance of losing nothing.

81%

Overconfidence is being compounded by other investor behavioral biases. For example, when investors do move out of cash or sell an investment that is currently “underperforming,” they often do so at exactly the wrong time. The number one reason that U.S. investors cite for investing additional savings is market appreciation.¹⁷ On the other side of the coin, 57 percent of U.S. investors and 63 percent of investors globally say they would consider a more conservative investment strategy after a decline in the value of their portfolio.¹⁸ This encapsulates the classic behavioral urge to buy high and sell low, and is a sign of not only investor recency bias, but also loss aversion.¹⁹

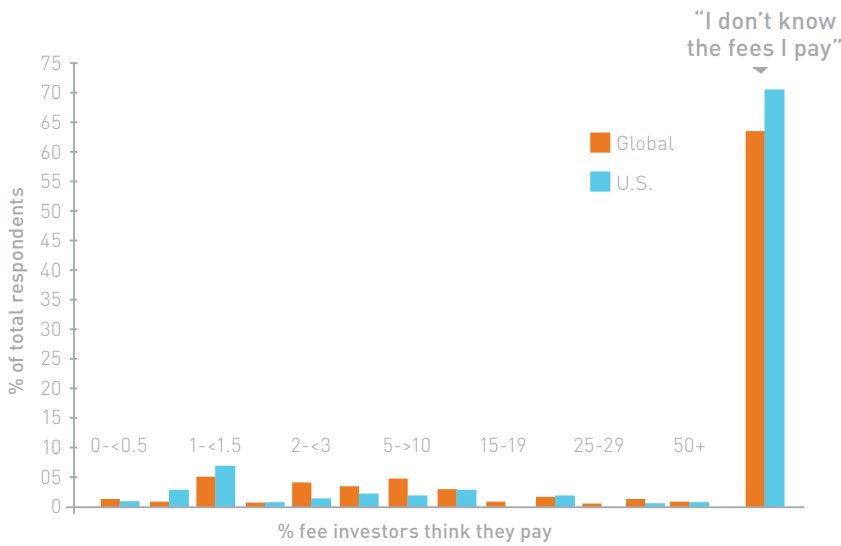
Behavioral research suggests that investors are likely to experience twice the amount of psychological pain when they lose money compared with the psychological pleasure they feel when they gain money.²⁰ This contributes to the disposition effect.²¹ Our research confirms this bias. Only 18 percent of U.S. investors and 21 percent of investors globally will take a risk to increase a gain.²² Meanwhile, 86 percent of U.S. investors and 81 percent of investors globally will take a risk in the hopes of avoiding a loss.²³ This, in part, explains why investors treat products differently, based on whether they have experienced a loss or gain in cost basis.

A final key behavioral bias, which often affects individual investors, is mental accounting,²⁴ which encourages investors to keep their assets in more accounts than necessary and treat assets differently, depending on which account they reside in. This is a key barrier to optimal asset allocation and asset location, which can be addressed through a goals-based wealth-management approach.

Thanks to psychological biases, many investors feel disenfranchised about their finances: 48 percent of investors in the United States and Canada say they spend more time reading free catalogues than reviewing their investment statements.²⁵

Client misalignment #3 — Lack of knowledge about fees

A disenfranchised client inevitably leads to an unaware client. Seventy-one percent of U.S. investors and nearly two-thirds of retail investors globally do not know what they pay in fees.²⁶ Of these, 45 percent of U.S. investors and 44 percent of investors globally say they find it too difficult to determine their fees.²⁷ Many other investors believe they know the fees they pay, but their actual estimates are often wildly inaccurate. Even when investors know how much they are paying, they don't know if it is reasonable — particularly if they don't understand the value they are receiving.



The fees investors *think* they pay across their investments.²⁶



Advisors are Constrained

To go back to looking at a problem from a different point of view, let's look at the similarities between a doctor and today's advisor.

Every few months, the doctor receives a phone call from his patient. The doctor spent years in medical school, has excellent professional experience and is aware of new treatments for back pain that might help his patient get well. But all the patient wants is more pills, and the doctor feels he has no choice but to prescribe them.

Every few months, the advisor receives a phone call from his client. The advisor has earned his CFP certification, has years of experience and is aware of a goals-based wealth-management approach that might help his client stay on track and pursue the investment outcomes that are most

meaningful over time. But all the client wants to talk about is why his portfolio lost value last quarter, and the advisor feels he has no choice but to honor the client's request.*

What do the doctor and the advisor have in common?

In their effort to please their patient and client, they have narrowly defined their skill-set and value proposition.

Advisors are overemphasizing their ability to select and allocate to investment products while underemphasizing skills that can help clients reach their long-term goals by looking at the full picture.

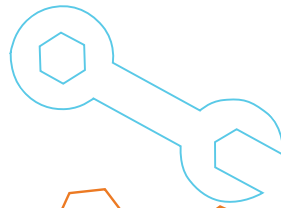
This is linked to the short-term nature of many conversations with clients. Discussions are not necessarily holistic either; advisors do not always have visibility into all of their clients' assets, and they lack the full tool set needed to provide optimal guidance across the household.

Advisor misalignment #1 — Narrow definition of advisor skills

Many advisors are limiting their value proposition to their skill in selecting and allocating to investment products. This is done with the aim of scaling and differentiating their practices. Deeply understanding the goals and behaviors of every client can seem like a time-consuming barrier to scaling one's practice, which leads to the temptation to focus on products and asset allocation. Additionally, advisors may feel more comfortable with differentiating their practices based on their investment

* Hypothetical example.

Investor/Advisor Conversation Misalignments



53% of U.S. investors and **57%** of investors globally trade at least monthly.³⁴

47% of U.S. investors and more than half of investors globally think it is important to make decisions over a short-term time horizon.³³

58% of U.S. investors and **65%** of individual investors globally believe that technology will do a better job of meeting their needs than humans.²⁹

“Advisors spend too much time trying to run money. It’s not their primary value add. FAs who think their value add is to pick a better fund than the broker down the street are using a dying business model.”

processes. On the surface, this may seem more efficient than doing a deep dive with each new prospect and outlining an individualized plan.

There are two major downsides to this approach. One downside is that the investment function is becoming increasingly commoditized. With robo-advisors on the rise²⁸ and bringing a focus on low cost and user-friendly interfaces, investors are beginning to question whether advisors’ fees are justifiable. Fully 58 percent of U.S. investors and 65 percent of individual investors globally believe that technology will do a better job of meeting their needs than humans.²⁹ It’s risky for advisors to pit themselves against these new entrants on the basis of investment returns alone;³⁰ advisors are aware of this

risk. Over the next 10 years, advisors feel they will see the greatest gaps in skill-set within their organizations in the area of identifying alpha opportunities.³¹

The other, more fundamental downside is that advisors can and do provide significant value in other areas. The role of advisor financial planning platforms and their ability to streamline the goals-based process cannot be underestimated. Going forward, advisors will have to do a better job of demonstrating that value to clients. We address this in detail in our case study and recommendations sections.

– HEAD OF RESEARCH
AT LARGE REGIONAL
BROKER/DEALER



Investors want to know why their portfolios lost value, underperformed a benchmark or didn't keep up with a friend's portfolio over the past month, quarter or year.³²



75%

of advisors say the media has the effect of causing investors to be more focused on the short term.³⁵

“Investors have been trained to evaluate success based on whether the statement of their portfolio value has risen or fallen in the past month. If it has fallen, they call their advisor.”

– SENIOR EXECUTIVE
AT LARGE NATIONAL
BROKER/DEALER

Advisor misalignment #2 — The wrong conversations

The second area of misalignment between clients and advisors is the short-term and market-oriented nature of many of their conversations. Advisors know that clients' long-term goals are what matter most. But in an effort to provide top-notch client service, they do their best to give clients what they want in the near term as well. Unfortunately, these two aims sometimes conflict.

Clients want to know why their portfolios lost value, underperformed a benchmark or didn't keep up with a friend's portfolio over the past month, quarter or year.³² In fact, 47 percent of U.S. investors and more than half of investors globally say they think it's important to make decisions over a short-term horizon.³³ Investors are also trading far too frequently, given the long time horizon associated with their goals: 53 percent of U.S. investors and 57 percent of investors globally trade at least monthly.³⁴ With investment-themed television programs blurring the line between investing and trading, it's easy to see how

clients can be swept away by the idea that strong performance (or the ability to reach long-term goals) requires constant tinkering and frequent trading. This is making advisors' jobs harder; 75 percent of advisors say the media has the effect of causing investors to be more focused on the short term.³⁵

Because of this pressure, client conversations are often far too short-term oriented and too focused on markets. Indeed, advisors themselves appear to be swayed by past performance. Advisors say that past performance is the number one reason they select products.³⁶ Naturally, this shifts the focus away from discussions about life events that could impact the investor's financial situation, as well as dialog on progress toward the client's goals. When goals are addressed, they are often relegated to the confines of a static financial plan. This serves as a snapshot of the client's situation at the time of onboarding, but often does not accommodate the client's shifting goals over time. It also fails to take into consideration the client's dynamic behavioral profile.

Advisor misalignment #3 — Limited view of client financial situations

The third misalignment between investors and advisors is that advisors are often unable to view, advise on and derive their compensation from their clients' full financial picture. Many investors own multiple accounts, and products purchased at different times from different advisors for different reasons that are "managed" with little to no coordination. The result is disjointed and uncoordinated asset allocation and asset location among multiple products and accounts, often with asset allocations that are the same for qualified and non-qualified assets.

This lack of coordination misses out on the significant advantages of optimal asset location. According to Morningstar, Inc., optimal asset location can contribute up to 52 basis points per year in incremental after-tax returns, which can add up to hundreds of thousands of dollars over the course of a decades-long investment lifetime.³⁷ Without this holistic view, advisors find it impossible to deliver optimal advice and clients cannot achieve the best possible outcomes.

Advisor misalignment #4 — The advisor's toolbox lacks key tools and coordination

The key steps of goals-based wealth management include:

- Goal Discovery, Prioritization and Planning

- Investment Proposal, Product Selection and Multiple Account Asset Allocation and Asset Location
- Ongoing Plan Monitoring, Rebalancing and Management
- Optimal Income Sourcing from Multiple Accounts and Products

While some of these tools are in place, the ability to deliver improved outcomes so clients can achieve their goals is in part predicated on the coordination of all these elements. A number of leading organizations are currently connecting the dots to make it easier for advisors to track how their clients are doing against their stated goals and demonstrate how to improve their outcomes. As we will discuss in the next section, investments that can produce improved outcomes do not come inexpensively.



Organizations are Cautious

The hospital administrator knows about innovative new treatments for back pain. But the expense is steep, and the hospital has made investments in infrastructure and technology in the past that didn't work out as hoped. The hospital administrator needs to stay within budget, and there are many other pressing and costly priorities. He is tempted to put off the expense and wait to see if it is successful in other hospitals.

The advisor's organization knows about innovative new ways to help clients increase the likelihood of achieving their goals. But the expense is steep, and the organization has made investments in infrastructure and technology in the past that didn't work out as hoped. The organization needs to stay within budget, and there is a temptation to put off the expense and wait to see if goals-based wealth management gains traction elsewhere.*

What do the hospital and the organization have in common?

They share the temptation to give in to short-term pressures and delay investing in infrastructure that will help patients and clients.

For organizations, there is an ongoing tension between the investment needed to empower advisors to help clients reach their long-term goals in a consistent and scalable fashion, and the pressure to deliver short-term profitability.

Organizations and advisors also struggle with "inertia" and continue to work to overcome incentive structures that have historically been out of alignment with investors' goals.

Organizational misalignment #1 — Change is hard

Investment products, asset management processes and the regulatory environment have become increasingly complex. Managing multiple accounts, assets and products in a cost and tax-efficient way over a decades-long investment lifetime is

even more complex in this environment. Given this complexity, no matter how proficient the advisor, managing products and assets cannot be done in an optimal fashion without major investments in technology and infrastructure at the organizational level.

And yet, short-term earnings pressure, particularly at publicly traded organizations, is a real and daily barrier to this sort of investment. In a survey of financial executives, 80 percent reported that they would decrease discretionary spending on research and development, advertising and maintenance; 55 percent said they would delay starting a new project to meet an earnings target — even if such a delay entailed a sacrifice in value.³⁸ Large broker/dealers and banks often fall into this category; they are under short-term earnings pressure and are subject to quarterly sell-side analyst scrutiny. This makes long-term investments in new infrastructure and technology a risky proposition.

Regional broker/dealers, independent broker/dealers and RIAs have a different, but related, problem. They sometimes lack the scale to invest in in-house capabilities, or the time or expertise to research outsourced options. In researching these outsourced options, a "road map" is needed to ensure the component pieces are integrated. In our interviews, we learned that most of the growth in the RIA channel is concentrated in three to four dozen top practices. These practices are aggressively expanding investment in

* Hypothetical example.

infrastructure, technology and staffing resources. Smaller, lower-margin RIAs risk being left behind.

Still, the thirst for new infrastructure and technology investments is ever present. A survey of advisory program sponsors found that outdated technology is the most concerning aspect of fee-based advisory programs. Fully 78 percent of organizations stated that the issue was somewhat or very concerning.³⁹

Organizational misalignment #2 — Change requires will and consensus

Advisors and organizations struggle with inertia, and both have been burned in the past. Historically, organizations have made investments in infrastructure and technology that have not yielded the hoped-for results. The industry is littered with examples of technology spending that haven't always met the advisors' and clients' expectations and/or needs. A prime example is the implementation of financial planning tools. The early versions were encyclopedic in length and often sat on the shelf because they were too complicated to comprehend, let alone implement. Many iterations later, with much more streamlined versions available, most organizations still struggle to move beyond a single-digit percentage of regular utilization.⁴⁰ This, and many other examples, causes organizations to think twice about being the first mover in making major investments.

Advisors have seen home-office initiatives fail in the past and can, therefore, be skeptical of new, unproven ideas. They

So is it worth it to make the kind of investment that is required?

There are many quantifiable benefits for the investor, the advisor and the organization. According to research by Morningstar, Inc., annual after-tax returns for investors can be increased by 38 basis points through tax-smart planning, 52 basis points through optimal asset location, and 54 basis points through intelligent withdrawals.⁴¹

What does this mean to the investor? A typical mass affluent 50-year-old using a goals-based approach can increase assets by more than 17% by a retirement age of 65. Over the next 25 years of retirement, assets can be increased by almost 65% after making tax-smart withdrawals when compared with a strategy not employing a tax-smart approach.⁴²

As baby boomers age, many advisors and organizations are concerned with the loss of assets due to withdrawals. By looking at the tax savings alone, the typical investor can experience a growth in assets and income. This can translate into a significant improvement in assets and revenues for the advisor and the organization. From a compliance perspective, not only does the investor benefit, but the advisor and the organization benefit from a greater consistency of experience and improved outcomes.

have been stuck in the performance paradox for so long that it can be difficult to envision a truly holistic, practical application of the concept of goals-based wealth management. To compound the problem, many advisors are nearing the end of their careers. The average advisor is over 50-years-old, and 43 percent of advisors are over the age of 55.⁴³ This increases the temptation to believe that change can be put off until after retirement (even though new approaches have the potential to raise the value of advisors' practices).

Advisor demographics are clear — with fewer advisors coming into the business and many advisors nearing retirement, there will be fewer advisors. At the same time, demographics show that a growing number of clients will need guidance. This all suggests that improved infrastructure and technology will necessarily play an increasingly important role in helping advisors to provide guidance; organizations must make a concerted effort to provide this support.

Organizational misalignment #3 — Financial incentives — perception matters

Organizations have taken great strides in aligning their incentives with those of clients. The advent of fee-based programs and open architecture has been a welcome development. So too has the proliferation of low-expense institutional share classes and the rooting-out of practices, such as churning client portfolios or selling variable commission product, to boost revenues.

Yet, there is still more to do. In order to optimize clients' access to all three levers of GBWM, even perceived conflicts of interest should be minimized. Clients should feel assured they are receiving the ideal mix of risk-adjusted returns, minimized taxes and low cost. Revenue-sharing arrangements and proprietary products can be challenging from this perspective, because they familiarize advisors with certain products and may influence the due diligence process. In behavioral finance, this is known as availability bias — the tendency to act on information that is more readily available. Finally, while this practice is becoming less

Only **53%** of U.S. investors believe their investment providers are acting in investors' best interest.⁴⁴

47% of individual investors globally believe their investment providers are acting in investors' best interest.⁴⁴

And nearly **two-thirds** of investors express no particular loyalty to their current investment providers.⁴⁵

Current State*

Psychological biases are recognized at a basic level but often not addressed

Client conversations focus on short-term market movements and investment products

Investors trust technology over humans

Focus is on the investment function

Assets are fragmented and managed in siloed accounts

Investors define success as beating the market or their peers, making gains without losses

Planning is static

Investors are suspicious of the financial services industry

Clients don't know what they pay in fees

Desire for short-term profit misaligns incentives

A Better State

Behavioral biases are acknowledged and managed

Client conversations focus on investor life events and progress toward long-term goals

People and technology are fully integrated

Holistic approach to financial needs, with advisor acting as the client's chief financial officer

Assets are consolidated and managed toward personal goals

Success is defined by all parties as achieving long-term goals

Planning is dynamic and adapts to investor and market changes

Investors trust the financial services industry

Fees are simple, easy to understand and tailored to the client's situation

Business success is measured long term

State of client management

State of wealth management

State of the industry

* Based on Center for Applied Research interviews and surveys.

common, the payouts that some organizations offer to hire or retain advisors are also a concern.

In order to expand market share and retain clients over the long term, organizations and advisors need to overcome investor skepticism. Only 53 percent of U.S. investors and 47 percent of individual investors globally believe their investment providers are acting in investors' best interest.⁴⁴ And nearly two-thirds of investors express no particular loyalty to their current investment providers.⁴⁵ Aligning and explaining incentives is a key way to improve this situation. It is also consistent with current areas of regulatory focus, and the perhaps inevitable march toward a fiduciary standard.

What would the world look like if there was a cure?

Imagine, due to the efforts of his doctor and hospital, our patient is one day cured of his chronic back pain. Suddenly, he will have the freedom to pursue so much more in life. Perhaps he will take up a sport or active hobby that he could never have enjoyed in the past. His daily life, and his long-term health, will be enhanced by this experience.

Just as a patient can be cured of his illness, so too can clients be cured of their internal conflicts — but only if advisors and organizations overcome their own misalignments. It can be difficult to see beyond the current state, so let's imagine what the provision of financial advice could look like in a better state.

To make this even more concrete, let's see what an advisor/client interaction could look like if the investor was "cured."

CASE STUDY

Demonstrating a better state

Markets have sold off significantly over the past few months, but Callie isn't too concerned. She trusts her advisor, Jane, and knows that short-term market movements are much less important than the long-term funded status of her goals. Besides, Callie has a good concept of her personal risk profile and knows that her portfolio will be protected from losses that feel too extreme.

Callie decides to meet with Jane, not because of the markets but because she is about to finalize the sale of her family business, which will represent a significant change in her financial situation. This conversation will represent step 3 of the goals-based wealth management process: ongoing plan monitoring, rebalancing and management. It took a lot to get here ...

When Jane took Callie on as a client two years ago, she walked Callie through step 1 of the goals-based wealth management process: goal discovery, prioritization and planning. Using financial planning software, Jane helped Callie identify and rank her goals by their relative importance. They also reviewed the anticipated time frame for each goal. This was a thorough discussion in which Jane explained why some of Callie's goals were unrealistic, given her current expenses and savings rate, and it resulted in Callie adjusting her budget and setting aside more savings.

Jane and Callie moved on to step 2: investment proposal, product selection and implementation. Based on an analysis of Callie's behavioral-investing characteristics, Jane offered a limited set of investment options. Instead of framing the conversation around investment products, Jane talked about increasing the probability of addressing Callie's upcoming liabilities while helping protect her from downside risk. Jane provided Callie with an app for her tablet that monitors the funded status of each goal, based on actuarial assumptions. Using her financial plan, forward-looking capital market assumptions and asset-location-optimization software, Jane also identified the ideal household asset allocation as well as asset location for her taxable, IRA, 401(k) and Roth IRA accounts to maximize Callie's tax savings.

Over the course of the past two years, Jane and Callie have stayed in contact and built a bond of trust. For example, junior members of Jane's team have helped Callie's daughter break a habit of incurring credit-card debt. This has demonstrated to Callie that Jane and her colleagues care about the financial well-being of her entire family.

Back to the present day: Jane begins the conversation by reviewing with Callie the funded status of each of her goals. This focuses the conversation on the future and on the long-term, rather than on market performance in the recent past. Callie decides that in order to increase the probability of reaching her goals, she will cut some discretionary expenses and set aside more savings.

Regarding Callie's pending sale of her family business, Jane reviews proceeds and determines the impact to her current plan and connects her with trusted partners. Jane works closely with an accountant, a psychologist and an attorney. The psychologist addresses the emotional component of selling the family business. The accountant advises Callie on tax implications of the sale of the company. The lawyer reviews the contracts that detail the vesting schedule for Callie's stock options.

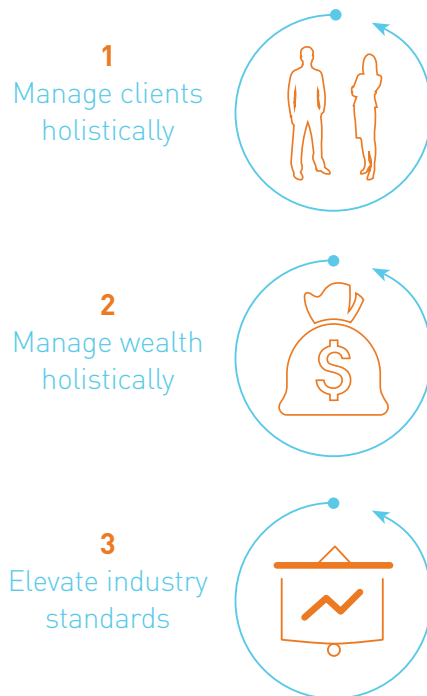
The value that Jane brings to the table is clear to Callie. Jane is Callie's "chief financial officer." Wherever markets go and whatever the change in her life circumstances, Callie knows that she can turn to Jane for high-quality, unbiased advice. Ultimately, this will set Callie up for success in the fourth step of the process, optimal income sourcing from multiple accounts and products, when she is ready to retire.

Case study is a hypothetical example.

Recommendations

At the broad level, the implementation of goals-based wealth management and delivery of personal performance is the key to overcoming misalignments. Yet, an appropriate ecosystem must be created to make this possible.

Through our extensive interviews with executives, advisors and industry thought leaders, we catalogued the best practices that have helped them overcome misalignments. We vetted these behaviors to identify the most successful ones. Based on our six-month analysis, we have categorized them into three areas of focus.



Recommendation #1: Manage clients holistically

Truly comprehensive financial advice must begin with the holistic management of the financial lives of clients and their families. This requires a deepened understanding of investor behavior, as well as an expanded definition of “client,” to include spouses and multiple generations.

Despite its emerging popularity, the field of behavioral finance is still relatively new and in the early stages of being integrated into the advisor/client relationship. While common investor behaviors have been identified and well-documented, there is still a lack of consensus about how to deal with these behaviors in a comprehensive fashion. Being aware of human behavioral biases and integrating them in ongoing discussions by citing examples is an important educational process for clients. Organizations need to invest significantly in understanding investor motivations and behavior, harnessing them and utilizing them to encourage better investment outcomes.

On a macro level, some promising examples include efforts to analyze clients’ past spending and investing habits, segment clients by similar behavioral characteristics and identify disconnects between how clients respond to questions and how they actually behave. On a micro level, a structure should be put in place

that accommodates persistent psychological biases. For example, showing clients their progress toward goals — rather than the short-term returns of underlying products and investments — can help reduce the effects of short-termism and loss-aversion. Organizing clients' financial lives around their goals puts mental accounting into a more positive and constructive context.⁴⁶ In addition, reducing clients' choices to a manageable level helps to avoid choice paralysis.⁴⁷

On a day-to-day basis, advisors can also take steps to address counterproductive investor behavior. Advisors should consider speaking with clients in absolute dollar terms rather than in percentages, especially when evaluating goals and tolerance for risk. They can develop the habit of asking clients to repeat what they've been told during a conversation in order to evaluate whether the information has been processed, while using technology to keep records of past conversations for future reference. Finally, advisors should seek to understand their own biases. Sharing these biases with clients may actually build increased trust. Much of what we describe here is being addressed in the emerging GBWM frameworks that are in development at a number of leading organizations. Fundamental to serving clients in the GBWM framework is "know the customer." This includes knowing all of their financial circumstances and their

behavioral tendencies. As this is understood, implementing a game plan over time dramatically increases the likelihood of improved outcomes and the achievement of goals.

In addition to addressing behavioral biases, organizations and advisors need to expand their definition of "client." Historically, clients have been viewed as individual (typically male) heads of household. Moving forward, this framework no longer makes sense. Women are taking an increasing role in the management of their own and their families' finances.⁴⁸ Additionally, with a significant transfer of wealth on the horizon, adult children should also be included in the discussion.⁴⁹

In practical terms, this suggests that organizations should invest significantly in the development of women advisors and financial advisors from the gen X and millennial generations. Currently, two of the industry's top broker/dealers have oriented their training programs to focus on developing abilities that are pertinent to becoming a successful advisor, such as listening and relationship-building skills and behavior-based financial planning. Recruiting should be conducted with an eye toward identifying candidates who have high emotional intelligence (EQ).⁵⁰ An example of a test that could potentially be used to screen for high EQ is the MSCEIT (Mayer-Salovey-Caruso Emotional Intelligence Test).⁵¹

“After a thorough review of their financial picture, we point out disconnects between what prospective clients are saying, and what they are doing. We say: Here’s what we understand about you, here are the observations we have. If you want to go to the next step, you have to hire us ... 99% of the time, the prospect becomes a client.”

U.S.-BASED ADVISOR WHO RANKS IN TOP 100
ADVISORS BY ASSETS UNDER MANAGEMENT

Recommendation #2: Manage wealth holistically

As illustrated in the Callie case study, clients clearly have wealth-related needs that go well beyond those that are strictly investment related. Addressing the investment function in isolation ignores those other needs, and can even result in sub-optimal investment decisions because not all information is taken into account.

Holistic wealth management, on the other hand, involves a full, dynamic understanding of clients’ income statements and balance sheets, as well as projected future cash flows. This includes estimating human capital, accounting for real estate holdings and projecting future expenses.

Assuming advisors have listened well, validated the priorities and goals of clients, and agreed with clients about a goals-based plan, it naturally follows that implementing the plan in an optimal way is critical. This plan needs to be implemented

in the near term, and over many decades of the client’s lifetime.

Implementation requires rebalancing and being prepared for changes in the client’s personal circumstances, not to mention in the economy and markets. Effective, ongoing monitoring and rebalancing as well as periodic reassessments of priorities and goals in light of personal and market forces significantly raises the likelihood of success. Research conducted by Morningstar, Inc. suggests that a holistic plan that is executed in an optimal way can add up to 180 basis points in incremental after-tax returns.⁵² Clearly, this will have a meaningful impact on the client’s household achieving its objectives.

Once the initial implementation plan is established and the advisor and client agree on the frequency of reassessment, other factors need to be managed, monitored and optimized. The three key

“Right now, robo-advisors are relatively low-tech. They basically only offer asset allocation services. Soon, they will offer tax-efficiency, stress-testing, optimization, and other sophisticated services, such as intelligent withdrawal.”

– SENIOR EXECUTIVE AT LARGE BROKER/DEALER ORGANIZATION

levers of improved outcomes using a goals-based, holistic approach are:

- Risk-adjusted returns — improving returns while being mindful of risk has never been easy, especially since clients’ expectations of return and perception of risk are often not accurately captured by traditional measures. By coordinating asset allocation across the multiple accounts and products of the typical household with asset location in mind, clients can enjoy improved outcomes.
- Taxes — taxes are the largest cost that investors encounter;⁵³ reducing taxes across the multiple accounts typically found in client households translates directly into improved client outcomes.
- Cost — reducing investment costs also translates directly into improved client outcomes.

Doing all of the above is complicated. Practically speaking, successful, ongoing, holistic wealth management can only be achieved by investing in people, infrastructure and technologies that enable improved outcomes and the achievement of goals.⁵⁴ Included in these technologies are robo-advisor services, which can be incorporated into human advisors’ existing practices.

A theme that was repeated in many of our interviews is that some advisors are trying to be all things to all clients. In the long-run, it’s far better to be aware of one’s own abilities, capitalizing on strengths and outsourcing areas of relative weakness.

Advisors should not be afraid to specialize. In our Callie example, we suggested that advisors can benefit from partnering with attorneys, accountants and psychologists. Other areas of growing importance include finding partners with expertise around the rising costs associated with various health care options. Organizations may also benefit from hiring or working with actuaries, who can, for example, help make projections about clients’ life spans and longevity risks. Additionally, industry-wide, there is a significant trend toward team building, which can help with spanning generations of investors and different client demographics as well as ensuring business continuity.⁵⁵

Recommendation #3: Elevate industry standards

With investor trust at low levels and regulatory pressure and political rhetoric on the rise, those in the business of providing financial advice should be aware of the industry’s public relations problem. It is our responsibility to take steps to address those concerns that we may consider overstated, because these fears stand in the way of our ability to reassure and guide clients toward the achievement of their financial goals.

Arguably the most controversial subject addressed in this paper is that of incentives. The industry has made great strides toward aligning incentives, but more can be done. Change to incentive structures is challenging. However, we believe that it should be shaped by two

guiding principles. First, business performance of organizations should be evaluated over longer time periods. Second, incentives should be structured in a fashion that encourages advisors to provide broad, holistic advice to clients and allows them to be truly agnostic about how they advise clients to allocate their assets.

In addition, advisors can consider offering clients fee structures that work best for their individual financial situations. For example, HENRY (high earning, not rich yet) clients might be charged a percentage of income or pay a retainer fee. Finally, if regulations were changed to allow advisors to charge on assets held-away, it would both align incentives and improve advisors' ability to monitor clients' full financial pictures.

The industry should also work toward establishing minimum standards for

advisors. These should include ethical training, as well as a minimum level of practical knowledge. Examples of laudable efforts include the CFA Institute's code of ethics and professional standards, the CFP code of ethics and IMCA's ethics and standards. Ethical standards such as these should be required, rather than optional. Advisors should be expected to place the integrity of the profession and the interest of clients above their own interests; they should act with integrity, competence and respect; and they should maintain and develop their professional competence. Ideally, this should also include continuing education requirements. The implementation of standards would allow us to define a career in our industry as a profession and would help protect clients from the unscrupulous few who would seek to take advantage.⁵⁶

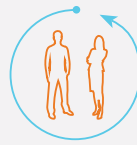
Tactics

The infographic at right shares 34 specific tactics, which our research identifies as being opportunities for advisors and organizations to overcome misalignments and deliver better value to clients.

Overcoming the Three Cs:

Each tactic corresponds to one misalignment.

- Clients are Conflicted**
- Advisors are Constrained**
- Organizations are Cautious**



Manage clients holistically

- Simplify the process and offer fewer product choices — avoid choice paralysis
- Show clients their progress toward specific goals rather than returns in specific accounts — this frames mental accounting in a positive way
- Educate clients — in each meeting with clients, tell a memorable story that imparts one important financial concept
- Provide constructive feedback to clients about disconnects between their long-term goals and their present behaviors
- Diagnose client biases and create systems that accommodate and incorporate them
- Understand and explain your own biases to clients
- Analyze historical spending patterns to estimate future spending needs by using software to review past bank and investment statements
- Discuss results (particularly potential future losses) in absolute rather than percentage terms
- Have and share a story about why you entered the business
- Keep records of meeting notes to help guide future conversations and to neutralize hindsight bias
- Video conference meetings with clients
- Encourage the use of a tablet for long-distance conversations
- Automate your processes, including client-service models, market updates and scheduled calls with clients
- Ask clients to reiterate what you told them. Do this in meetings systematically
- Ask clients what's important to them instead of talking about what you think is important; ask open-ended questions



Manage wealth holistically

- Work with clients to identify and rank goals, taking behavior into account
- Use technology to help clients visualize their goals — this can include pictures, even 3D images
- Discuss the definition of “advice” with your client. Advice should be understood holistically, rather than in an investment or portfolio-specific context
- Move away from traditional market benchmarks, toward goal-oriented benchmarks
- Include the whole family in the conversation
- Manage, or at least view, all of clients’ accounts, as well as other assets
- Systematically review your practice model every two to three years to make sure you’ve kept up with the times
- Create a systematic goals-based wealth-management platform that connects the planning process with cost- and tax-efficient implementation, ongoing monitoring, rebalancing, optimal income sourcing and client reporting
- Partner with automation services (basic asset allocation, taxes and income sourcing are automated)
- Know your strengths; partner with other professionals, internally and externally, to overcome your weaknesses — start small and establish fee/revenue-sharing agreements in advance
- Move beyond the active/passive debate and focus on using the right investments and tools to help clients reach their goals
- Market services responsibly to avoid messaging that might support a short-term outlook



Raise industry standards

- Offer clients a choice of how their advisors are compensated — this helps onboard non-traditional clients such as HENRYs⁵⁷
- Compensate advisors equally, regardless of product used
- Evaluate business success over longer time periods
- Create minimum standards to be an advisor — make it a true profession
- Train and incentivize new advisors to build relationships rather than make quick sales⁵⁸
- Hire individuals with high emotional intelligence (for example, psychology majors with finance minors, who score well on a Mayer-Salovey-Caruso Emotional Intelligence Test)
- Hire women and junior advisors — this can help with understanding the unique needs and communication preferences of millennials and female clients

Conclusion

Clients want performance more than any other value driver. It follows that advisors should define their value around its delivery.

Yet, performance must be clearly defined. It doesn't stop with short-term returns or enhanced product choices. Performance means holistically understanding clients' needs and helping them to achieve their life and financial goals. It means delivering income in retirement, planning for long-term health-care needs, paying for education — putting clients' lives at the center of everything that advisors and organizations do.

Clients, advisors and organizations have the ability to escape the performance paradox. They just need to seize the opportunity to do so.

The benefits of hiring a holistic financial advisor should be clearly explained to clients. This would empower them to trust financial advisors and the industry in general, because they would understand that their interests come first. Most importantly, clients should fully comprehend their own goals and be aware of their progress toward achieving them.

By embracing goals-based wealth management, personal performance and the recommendations outlined in this paper, advisors and organizations can overcome the performance paradox, and broaden their value propositions. Ultimately, this can lead to better outcomes for the advisor, the organization and most importantly, the client.

Notes and References

- ¹ State Street Center for Applied Research Survey Analysis 2012; Question Asked: Which of the following capabilities will become increasingly important to you over the next 10 years? Respondents included institutional and retail investors.
- ² State Street Center for Applied Research Survey Analysis 2012; Question Asked: Based on your investment providers' current capabilities, which of the following areas represent the largest weaknesses? Respondents included institutional and retail investors.
- ³ In an analysis of more than 1,179 Danish, European and U.S. funds, active funds were found to not significantly outperform passively managed mutual funds and ETFs. Source: Friedrichsen, Otto. "Are Actively Managed Mutual Funds Really Worth It?" 2013. Web. <http://pure.au.dk/portal-asb-student/files/52840410/Are_Actively_Managed_Mutual_Funds_Really_Worth_It_A_Study_On_Performance_of ETFs_Active_and_Passive_Mutual_Funds_in_Denmark_Europe_and_USA.pdf>.
- ⁴ "For international developed- and emerging-market managers, failure to match or exceed benchmarks has been 85% and 86%, respectively. For bond managers, failure rates have averaged 78% (including 93% for high-yield bonds and 86% for mortgage bonds) over more than five-year time horizon." Source: S&P's SPIVA Scorecard 2012.
- ⁵ "Specifically, we observe that the proportion of skilled funds decreases from 14.4 percent in early 1990 to 0.6 percent in late 2006, while the proportion of unskilled funds increases from 9.2 percent to 24.0 percent. Thus, although the number of actively managed funds dramatically increases over this period, skilled managers (those capable of picking stocks well enough, over the long-run, to overcome their trading costs and expenses) have become exceptionally rare." Source: Barras, Laurent; Scaillet, Olivier; and Wermers, Russ. "False Discoveries in Mutual Fund Performance: Measuring Luck in Estimated Alphas." *The Journal of Finance* 65.1 (2010): 179-216.
- ⁶ The average equity investor underperformed the S&P 500 by an average annual deficit of 4.66% over the last 20 years, and the average fixed-income (bond) investor underperformed the Barclays Aggregate Bond Index by an average annual deficit of 5.40% over the last 20 years. Source: Halbert, Gary. "Why Most Investors Consistently Underperform the Market." Profutures Investments. May 5, 2015. Web. <<http://www.profutres.com/article.php/958/>>.
- ⁷ State Street Center for Applied Research Survey Analysis 2014; Question asked: Which of the following would better enable you to achieve your investment goals? If I were better educated in investing; If I devoted more time to my investment goals; If product fees were lower; If I had good/better advice from a financial advisor or someone I trust; If investment advice were more affordable; Nothing — I do achieve my investment goals; Don't know; Other.
- ⁸ State Street Center for Applied Research Survey Analysis 2014; Question asked: What is the primary reason you invest? Retire comfortably; Accumulate wealth to buy a home in the future; Support children/other family members/leave an inheritance; Make extra money on the side for spending; Because I enjoy investing; I don't invest; Because I have been told it would be beneficial for me; Other.
- ⁹ State Street Center for Applied Research Survey Analysis 2014; Question asked: How do you personally define success when investing? Being on-track to achieving my long-term investment goals; Only making gains and no losses; Outperforming the market; Achieving my short-term investment goals; Outperforming my friends/family/colleagues; Other.
- ¹⁰ State Street Center for Applied Research Survey Analysis 2012; Question asked: Which financial steps are you taking to prepare for retirement or during retirement in the next 10 years, if any? More aggressive — plan long-term; More aggressive — need extra return; More aggressive — other reason; More conservative — protect current savings; More conservative — save enough to retire comfortably; More conservative — other reason; Other reason; Don't know.
- ¹¹ State Street Center for Applied Research Survey Analysis 2014; Question asked: What proportion of your assets is currently invested in the following asset classes? Cash; Equity; Fixed Income; Alternatives; Commodities; Inflation protection.
- ¹² State Street Center for Applied Research Survey Analysis 2014; Question asked: What proportion of your assets is currently invested in the following asset classes? Cash; Equity; Fixed Income; Alternatives; Commodities; Inflation protection.
- ¹³ State Street Center for Applied Research Study 2012; "The Influential Investor: How Investor Behavior is Driving Performance."
- ¹⁴ State Street Center for Applied Research Survey Analysis 2014; Based on aggregated responses to 13 financial literacy questions.
- ¹⁵ Overconfidence Bias — demonstrating undeserved faith or confidence in one's own judgments, to a higher degree than the judgment's objective accuracy warrants. Source: Pallier, Gerry; Wilkinson, Rebecca; Danthiir, Vanessa; and Kleitman, Sabina. "The Role of Individual Differences in the Accuracy of Confidence Judgments." *The Journal of General Psychology* 129.3 (2002): 257-299.
- ¹⁶ Svenson, O. "Are we all less risky and more skillful than our fellow drivers?" *Acta Psychologica* 47 (1981): 143-148.
- ¹⁷ State Street Center for Applied Research Survey Analysis 2014; Question asked: What could cause you to invest more of your savings?
- ¹⁸ State Street Center for Applied Research Survey Analysis 2014; Question asked: If your portfolio declined by 20% in one year, would you consider moving to a more conservative investment strategy?
- ¹⁹ Loss Aversion — permitting losses and disadvantages to shape preferences differently than gains or advantages. The utility derived from a gain is much lower than the utility given up by an equivalent loss. Source: Tversky, Amos and Kahneman, Daniel. "Loss Aversion in Riskless Choice: A Reference-Dependent Model." *The Quarterly Journal of Economics* (November 1991): 1039-1061.

- ²⁰ Kahneman, Daniel. *Thinking, Fast and Slow*. New York: Farrar, Straus and Giroux, 2011. Print.
- ²¹ Disposition Effect — hastily selling assets whose price has increased while retaining for too long assets that have dropped in value. Source: Shefrin, Hersh and Statman, Meir. "The Disposition to Sell Winners Too Early and Ride Losers Too Long: Theory and Evidence." *The Journal of Finance* 40.3 (July 1985): 771-790.
- ²² State Street Center for Applied Research Survey Analysis 2014; Question asked: Which scenario would you prefer? A 100% chance of winning \$80,000; An 80% chance of winning \$100,000 and 20% chance of winning nothing.
- ²³ State Street Center for Applied Research Survey Analysis 2014; Question asked: Which scenario would you prefer? An 80% chance of losing \$100,000 and a 20% chance of losing nothing; A 100% chance of losing \$80,000.
- ²⁴ Mental Accounting Bias — treating one sum of money differently than another equal-sized sum based on how the money is categorized. People mentally group their assets into non-interchangeable mental accounts, when in reality money is inherently interchangeable. Source: Thaler, Richard. "Mental Accounting Matters." *Journal of Behavioral Decision Making* 12 (1999): 183-206.
- ²⁵ State Street Center for Applied Research Survey Analysis 2013 — "The Forgotten Investor: Investors tune out financial reforms against backdrop of mistrust" Question asked: I spend more time reading free catalogues that come in the mail than reading financial statements from my provider. Agree; Disagree.
- ²⁶ State Street Center for Applied Research Survey Analysis 2014; Question asked: Do you know the approximate average annual fees you pay across your investments and savings? (%) Yes; No.
- ²⁷ State Street Center for Applied Research Survey Analysis 2014; Question asked: Do you know the approximate average annual fees you pay across your investments and savings? (%); If not, why? Too difficult to calculate/find out; No time; No interest.
- ²⁸ Assets managed by the top robo-advisors are growing rapidly, up 65% in less than 8 months to \$19 billion by the end of 2014. This growth rate is impressive, but compared with the overall size of the advisory market, this number remains miniscule. However, some sources expect this rapid growth to continue unabated. Consulting organization A.T. Kearney aggressively projects that robo advisory assets will reach \$2.2 trillion by the year 2020. Currently, the competitive advantage of robo-advisors generally boils down to simplicity and cost, making millennials a natural target market. But these cheap and simple asset allocation programs also have the potential to quickly evolve to offer benefits that could be attractive to a wealthier demographic. Source: *Corporate Insight*. Web. <<http://public.corporateinsight.com/news-events/in-the-news/robo-assets-grew-significantly-in-14>>; Bloomberg <<http://www.bloomberg.com/news/articles/2015-06-18/robo-advisers-to-run-2-trillion-by-2020-if-this-model-is-right>>.
- ²⁹ State Street Center for Applied Research Survey Analysis 2014; Question asked: In the future, do you think that technological advancements in providing financial advice will better serve individuals with regards to value and cost than financial advisors? Yes; No.
- ³⁰ In the aggregate, advisors are struggling to outperform current alternatives as well. Portfolios managed directly by advisors have underperformed those managed by home offices by 3.15%. Cerulli attributed these results to home offices remaining invested throughout the financial crisis as well as better investment selection. Source: Cerulli research "Managed Accounts 2015: Battle for Discretion," 2015. Web. <<https://www.cerulli.com/publications/managed-accounts-2015-battle-for-discretion-P00026P>>.
- ³¹ State Street Center for Applied Research Survey Analysis 2014; Question asked: Where does your organization have/expect to have the largest gaps in your employee qualities over the next 10 years? Select up to two.
- ³² State Street Center for Applied Research Survey Analysis 2014; Question asked: How do you personally define success when investing? Being on-track to achieving my long-term investment goals; Only making gains and no losses; Outperforming the market; Achieving my short-term investment goals; Outperforming my friends/family/colleagues; Other.
- ³³ State Street Center for Applied Research Survey Analysis 2012; Question asked: Which value describes YOU most today/ in 10 years? Long-term — Strongly agree; Long-term — Agree; Long-term — Somewhat agree; Short-term — Strongly agree; Short-term — Agree; Short-term — Somewhat agree.
- ³⁴ State Street Center for Applied Research Survey Analysis 2014; Question asked: How often do you trade in financial markets (e.g., stocks, bonds, currency)? Daily; Weekly; Monthly; Quarterly; Semi-annually; Yearly; Every few years; Never.
- ³⁵ State Street Center for Applied Research Survey Analysis 2014; Question asked: What are the most important positive or negative effects media has? Causes investors to be more focused on the short-term (e.g., increased trading, buy high/sell low); Causes my clients to be more skeptical and less trusting of their providers; Gives me instant access to necessary information; Increases my awareness of current trends; Increases the transparency of the investment management industry; Causes my clients to be less financially sophisticated.
- ³⁶ State Street Center for Applied Research Survey Analysis 2014; Question asked: Which factors are the key determinants for most financial advisors to recommend an investment product to their clients? Select the top two. Past performance of investment product; Reputation/trustworthiness of the investment provider; Appropriateness of the product to investor's goals and strategy; The amount of commission/rebate they receive for the product; Low fees of the product compared with other investment providers; Recommendation from peers; One-stop-shop offering of provider/convenience.
- ³⁷ A detailed analysis of the cost savings associated with tax-smart asset allocation is available: jack.sharry@lifecycle.com.
- ³⁸ Graham, John R.; Harvey, Campbell R.; and Rajgopal, Shivaram. "Value Destruction and Financial Reporting Decisions." <<http://ssrn.com/abstract=871215>>, (September 6, 2006).

- ³⁹ Web. <http://fundfire.com/c/958594/94774?referrer_module=SearchSubFromFF&highlight=%22revenue%20sharing%22>.
- ⁴⁰ Center for Applied Research Interviews. 2015.
- ⁴¹ Blanchett, David and Kaplan, Paul. "Alpha, Beta, and Now...Gamma." Morningstar Investment Management. 28 August 2013. Web. <<https://corporate.morningstar.com/US/documents/ResearchPapers/AlphaBetaandNowGamma.pdf>>.
- ⁴² Blanchett, David and Kaplan, Paul. "Alpha, Beta, and Now...Gamma." Morningstar Investment Management. 28 August 2013. Web. <<https://corporate.morningstar.com/US/documents/ResearchPapers/AlphaBetaandNowGamma.pdf>>.
- ⁴³ "43% of Advisors Nearing Retirement, Says Cerulli," *Financial Advisor*, Web. <<http://www.fa-mag.com/news/43--of-all-advisors-are-approaching-retirement--says-cerulli-16661.html>>. [January 17, 2014]
- ⁴⁴ State Street Center for Applied Research Survey Analysis 2014; Question asked: To what extent would you agree or disagree with the following statements in today's environment? Financial Institutions are most likely to offer products & services in the investment organization's own best interest; Financial Institutions are most likely to offer products & services in the client's best interest.
- ⁴⁵ State Street Center for Applied Research Survey Analysis 2012; Questions asked: Based on your current interactions with your primary investment provider, please indicate the extent to which you agree or disagree with the following statements. Please rank on a scale of 1-6 where 1=Strongly disagree and 6=Strongly agree. 1) I go to my primary investment provider first for any new investment need; 2) I am not seriously considering switching providers for my current investments; 3) I recommend my provider to my peers.
- ⁴⁶ Mental Accounting Bias — treating one sum of money differently than another equal-sized sum based on how the money is categorized. People mentally group their assets into non-interchangeable mental accounts, when in reality money is inherently interchangeable. Source: Thaler, Richard. "Mental Accounting Matters." *Journal of Behavioral Decision Making*. 12 (1999): 183-206.
- ⁴⁷ Sethi-Iyengar, Sheena, Huberman, Gur and Jiang, Wei. *Pension Design and Structure: New Lessons from Behavioral Finance*, pp. 88, 91. Oxford University Press. 2004.
- ⁴⁸ In 2014, in the United States, women had decision-making power over \$11.2 trillion, or 32% of the nation's \$28.6 trillion in investable assets, according to the Center for Talent Innovation. Source: Maxey, Daisy. Where Are the Female Fund Managers? *The Wall Street Journal*. July 6, 2015. Web. <<http://www.wsj.com/articles/SB11670627175020993366304581066292742744646>>.
- ⁴⁹ Currently, 45% of investors admit that wealth is not openly discussed in the family. Source: State Street Global Advisors' Survey, "Money in Motion," January 2015. 400 advisors and 560 investors were surveyed nationally.
- ⁵⁰ Emotional intelligence can be beneficial to the investment decision-making process as well, promoting a focus on meeting long-term goals and thereby more suitable levels of aversion to risk and loss. Research also shows us that investors who incorporate their IQ and EQ may have improved performance. For example, see Ameriks, John, Wraniak, Tanja, and Salovey, Peter, "Emotional intelligence and investor behavior." *CFA Digest* 39 no 3, August 2009.
- ⁵¹ Developed by academics at Yale and the University of New Hampshire in cooperation with MHS, the Mayer-Salovey-Caruso Emotional Intelligence Test (MSCEIT™) evaluates Emotional Intelligence through a series of objective and impersonal questions. Web. <<http://www.mhs.com/product.aspx?gr=io&id=overview&prod=msceit>>.
- ⁵² Blanchett, David and Kaplan, Paul. "Alpha, Beta, and Now...Gamma." Morningstar Investment Management. August 28, 2013. Web. <<https://corporate.morningstar.com/US/documents/ResearchPapers/AlphaBetaandNowGamma.pdf>>.
- ⁵³ Hearts & Wallets annual "Inside Retirement Advice 2014: At Retirement Focus — How Benchmarking Today's At-Retirement Advice & Guidance Points the Way to Future Improvements"; LifeYield.
- ⁵⁴ Goals-based financial planning tools need to be connected to tax-optimal implementation technologies that consider asset location, model coordination and assignment, portfolio monitoring, rebalancing and intelligent income sourcing from different account types and income sources, such as Social Security, pensions and investment real estate holdings. And of course, technology is required to determine whether the client is ahead, behind or on track. Technologies exist today that quantify the potential future benefits of tax-smart, cost-effective, ongoing management and, in addition to improved after-tax outcomes, can provide peace of mind to the investor that helps them stay on track and not succumb to the all too familiar phenomenon of buying high and selling low.
- ⁵⁵ In 2015 Top 1,200 Financial Advisors ranking, published in February, advisors on average had 11 people on their teams, up from eight in 2012. Source: Garmhausan, Steve. "Financial Advisors: 3 Winning Teams." *Barron's*. July 4, 2015. Web. <http://www.barrons.com/articles/financial-advisors-3-winning-teams-1435894044?mod=_newsreel_1>.
- ⁵⁶ Studies suggest that industry standards are beneficial. For example, in the UK, the most productive sectors utilize standards: aerospace and defense, for example, increased productivity by 20.1% between 2005 and 2014, while the UK average was 4.9%. Respondents were asked about the usefulness of standards. More than three-quarters (84%) said using standards had enhanced their reputation. Nearly three-quarters (70%) felt that standards had improved the quality of supplier products and services. Source: "How standards benefit businesses and the UK economy." British Standards Institution. Web. <<http://www.bsigroup.com/LocalFiles/en-GB/standards/BSI-standards-brochure-how-standards-benefit-businesses-and-the-UK-economy-UK-EN.pdf>>.
- ⁵⁷ HENRY: High Earners, Not Rich Yet
- ⁵⁸ See for example, "Meet Mother Merrill's New Trainees," *OnWallStreet*, which references current trend.

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