Investment Insights
Consolidation vs. Personalization: Can Tech Make Everyone Happy?

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Key Takeaways

- Like the asset management industry, the financial advisory space has seen significant consolidation recently to gain scale. We assume this will continue.
- Scale might seem contrary to an advisor's ability to deliver personalized service to clients. Yet, we believe an advisor can build scale and still offer personalized service and investment choices.
- We believe non-investment services are more important to personalize for clients. Studies show these areas may add considerably more value than relative investment performance.
- Also, portfolio personalization has been made scalable with the growth of unified managed accounts (UMAs) and direct indexing, both of which free an advisor's time while enabling plenty of customization.

Consolidation on the Rise

Morgan Stanley, E-Trade, and Eaton Vance. Charles Schwab and TD Ameritrade. Franklin Templeton and Legg Mason. Asset management consolidation grabbed headlines in 2020, with many analysts pointing to a drive toward lower fees and greater product breadth likely to motivate more marriages in 2021 and years to come.

Meanwhile in the financial advisor space, Cetera Financial Group announced plans to acquire Voya Financial's retail brokerage business in February 2021, which followed a number of similar announcements in 2020, including LPL's decision to buy Waddell & Reed's wealth management business and Advisor Group's acquisition of Ladenburg Thalmann.

What's driving all this desire to build large financial advisory operations? One reason may be increasingly costly technology services—digital workflows, for example, or tech improvements that stem from greater regulatory and compliance burdens. In a post-COVID world in which all advisor/client interactions have grown more accustomed to virtual engagement, this trend seems unstoppable.

Indeed, whether through financial advisory consolidation or technological platforms available to firms of all sizes, we believe advisors who survive into the future will have access to scale.

Perhaps surprisingly, this emphasis on economies of scale still allows for customized portfolios. That's critical: Research by Morningstar Investment Management's Ryan Murphy, head of decision sciences, suggests that clients value the interpersonal elements of the financial advisor/client relationship the most.[1]

Of course, personalization today doesn't look like it did even 10 or 20 years ago. Today, technology has brought improvements to product offerings that offer advisors not only personalization but also scale. Rather than advisors creating one-of-a-kind portfolios of individually selected stocks, bonds, or mutual funds, today's personalization comes from managed portfolios, unified managed accounts (UMAs), and model marketplaces, which allow even smaller RIAs access to low-cost, customizable portfolios while someone else handles the middle- and back-office work.

But is there something insincere about personalization through scale? Can portfolios really be customized for the unique needs of each client if you rely on model portfolios?

It may not come as a surprise, but we would argue yes. The reality is that, while the nuances are different, the broad outlines of client needs tend to fall along a known spectrum across near-, intermediate-, and long-term investment horizons. Moreover, market outcomes are not infinite, so for the vast majority of people, tailored stock or mutual fund selection won't likely make a meaningful difference in the final analysis.

Where customization is meaningful and can vary relates to the details of the financial plan and the behavioral coaching that aims to help clients stay the course. Consider the many nuances of issues like taxes, estate planning, required minimum withdrawals, retirement expectations, or insurance. And while behavioral pitfalls are often fairly similar across investors, even the institutional types, the most impactful delivery is often personal. For the advisor who takes the time to invest in this effort, clients often stay the course. Morningstar researchers Blanchett and Kaplan found as much in 2013 and 2017 in their studies[2] of the impact of financial planning (see Exhibit 1).

Products That Can Personalize

Even so, we acknowledge that at times, personalization needs to go beyond financial planning and behavioral coaching. Whether it's a truly unique need or a matter of perception, advisors must be prepared to offer something different to certain clients. And as technology is driving the trend toward consolidation, it's also enabling new investment vehicles that can deliver both scale and customization.

Those vehicles are unified managed accounts, or UMAs, and direct indexing. Let's look at them in turn.

UMAs typically offer all of the scale of managed portfolios, with the added benefit of customization and whole-portfolio transparency and analysis. Before UMAs, advisors had to either treat accounts separately or spend time and resources bringing accounts together to analyze. UMAs deliver this reporting as part of the service.

1 Murphy, R., Sin, R., & Lamas, S. 2019. "The Value of Advice: What Investors Think, What Advisors Think, and How Everyone Can Get on the Same Page." Morningstar White Paper. https://www.morningstar.com/lp/value-of-advice

2 Blanchett, D. & Kaplan, P. 2013. "Alpha, Beta, and Now … Gamma," The Journal of Retirement, Vol. 1, No. 2, P. 29.

Exhibit 1 Researchers Estimate the Value (in Basis Points) of Financial Planning Activities Can Be Significant

Steps	Value Creating Activities	Vanguard	Morningstar	Envestnet	Russell Investments	Marsden et al.	Hackethal et al.	Von Gaudecker	Morningstar	Barber et al.	Dalbar	Geddes et al.	Blanchett
Understanding Your Life	Client assessment			>50	85	60							
	Asset allocation		45	28			19	50					
	Behavioral coaching	150			200–220				100	400	352		
	Tax management	0–75		100	50							190	
Your Financial Strategy	Goal-relative optimization		12										165
	Product allocation		33	82–85	25–35								
	Savings and withdrawal guidance	110	70										
Staying on Track	Rebalancing	35		44	30								
Total Estimated Value Added		370	160	>304	390–420	NA	NA	NA	NA	NA	NA	NA	NA

Source: Merrill Lynch, "The Value of Personal Advice," Fall 2016

The customization potential is limited only by the options offered on a platform. An advisor might dial risk up or down on a core multi-asset portfolio by pairing it with an equity or fixed-income separately managed account, or SMA. Or, higher-net-worth clients maybe prefer to build a portfolio of SMAs.

Note that these combinations are not created equally, nor should they be taken lightly. We have suggested advisors follow three main guidelines when combining portfolios in a UMA: Blend portfolios only to meet a specific need or known preference (low costs, for example); ensure each strategy plays a unique role in a combined portfolio (i.e., don't combine two risk-based multi-asset portfolios with a myriad of overlapping holdings); and look for differentiated results from the combined portfolio (a notably different risk profile, for example, or increased exposure to non-U.S. markets).

Another exciting product development is the accessibility of direct indexing. It's no secret that money has poured into ETFs by the billions in recent years, as investors have sought to lower costs and improve liquidity over mutual funds. With zero-commission trades now the norm, investors can move in and out of ETFs quickly and cheaply. But if there's one investment vehicle that's not personalized, it's the ETF, which dutifully tracks its index with no exceptions.

But what if a client doesn't want to hold every security in an ETF? This may be for a number of reasons, but in a world where interest grows every day in environmental, social, and governance (ESG) investing, that number has grown. Direct investing allows an investor to cheaply replicate the risk/return profile of an index while directly holding all, or a portion of the underlying stocks—enabling one to vote one's shares—or, in some cases, customizing the exposure by not holding certain index constituents. In addition to the transparency and security benefits of direct ownership, direct indexing also allows for tax-loss harvesting, which can be a real boon to wealthier investors.

Technology gains allow for scale for advisors of all sizes on a level not previously seen. But for many, that means not going it alone, and tapping into the economies of model portfolios. Models—and related technologies—enable advisors to focus on services where they can add the most value, while still empowering their ability to create personalized portfolios for clients. While consolidation and scale so often imply doing more with less, we think this is an example where advisors can do more with more. These are exciting times to be a financial advisor.

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