Investment Insight
Unlocking Growth: How Outsourcing Can Elevate Advisor Client Relationships

One valuable way financial advisors deliver value for clients is to help keep them invested during hard times.

Morningstar conducts an annual study called Mind the Gap, which analyzes dollar-weighted returns (translation: returns the average investor receives) across mutual funds and exchange-traded funds over trailing 10-year periods.

The study’s results are clear: The average investor underperforms the returns of the funds they invest in. Why the gap? Poorly timed purchases and sales of fund shares. Put simply, most investors tend to buy the most at the top and sell the most at the bottom.

The shortfall is created by human behavior, which is why it’s referred to as the behavior gap.

And these results are not specific to a single asset category. Investors—in aggregate—tend to underperform across stocks, bonds, alternatives, and even allocation funds.

**Exhibit 1** Mind the Gap: A Report on Investor Returns in the U.S.

<table>
<thead>
<tr>
<th>U.S. Category/Group</th>
<th>Investor Return %</th>
<th>Total Return %</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allocation</td>
<td>5.98</td>
<td>6.44</td>
<td>-0.46</td>
</tr>
<tr>
<td>Alternative</td>
<td>-6.92</td>
<td>0.96</td>
<td>-1.98</td>
</tr>
<tr>
<td>International Equity</td>
<td>3.30</td>
<td>4.89</td>
<td>-1.59</td>
</tr>
<tr>
<td>Municipal Bond</td>
<td>0.52</td>
<td>1.89</td>
<td>-1.37</td>
</tr>
<tr>
<td>Nontraditional Equity</td>
<td>2.10</td>
<td>4.16</td>
<td>-2.06</td>
</tr>
<tr>
<td>Sector Equity</td>
<td>6.42</td>
<td>10.80</td>
<td>-4.38</td>
</tr>
<tr>
<td>Taxable Bond</td>
<td>0.20</td>
<td>1.57</td>
<td>-1.37</td>
</tr>
<tr>
<td>U.S. Equity</td>
<td>10.99</td>
<td>11.77</td>
<td>-0.79</td>
</tr>
<tr>
<td>Overall</td>
<td>6.04</td>
<td>7.71</td>
<td>-1.68</td>
</tr>
</tbody>
</table>


The behavior gap isn’t a mainstream concept—you won’t see it discussed on CNBC—but it’s an area where financial advisors add tremendous value, particularly in their efforts to shrink the gap.
And if you talk with most advisors, the best way to close the gap is to stay in front of clients, constantly communicating with them, and building trust.

This might sound simple, but the reality of doing it across dozens — maybe even hundreds — of clients is anything but.

One simple way advisors can free up time to spend more time engaging clients? Outsourcing investment management.

Using Cerulli data, less than half of the financial advisor population is using model portfolios from third-party investment managers. But adoption is growing, and Cerulli forecasts that model assets could double by 2025.

**Exhibit 2 Models Landscape**

Why is model portfolio adoption growing? There are several reasons we believe are worth highlighting.

**Reason #1: Time Efficiency**

Many advisors spend considerable time on portfolio construction. It’s estimated that, on average, time spent managing portfolios comprises nearly 15% of advisor’s time, which translates to more than 300 total hours per year.
When you consider the administrative tasks associated with portfolio management — making sure portfolios sit inside mandated targets and checking for tax-loss opportunities to name a few — the numbers could be much higher.

And while some advisors enjoy these aspects of the job — others do not. The latter could potentially benefit from third-party solutions.

**Reason #2: Potential for More Consistent Outcomes**

One major risk for financial advisors: giving a client an unexpected outcome.

Using model portfolios can potentially increase consistency and lower return dispersion.

The graphic below compares the returns of advisor-managed accounts (left) versus managed accounts by a model provider (right). You can see the managed accounts by a model provider have significantly less dispersion than the advisor-managed accounts — depicted by more dots hugging the central boundary.
To be clear, what is outlined above does not mean better performance—we are not advocating that model providers are better investors than advisors!

Rather, this graphic speaks to the fact that model providers often have the technology, systems, and people to keep portfolios within an expected range of volatility—tasks that often require significant manual time.

**Reason #3: Instill Discipline**

Rebalancing is a critical element in delivering clients a great investment experience. An investment portfolio can morph into something totally different if left unchecked.

For example, if a client was invested into a standard 60% stock/40% bond portfolio in 2007 and never rebalanced, they would have ridden a roller coaster over the next decade.

By 2010—after the crisis—the portfolio would have been roughly 50% stocks/50% bonds. Fast-forward 10 years—after a strong equity bull market—the portfolio would have been roughly 70% stocks/30% bonds.

**Exhibit 5 Instill Discipline**

![Sample Portfolio Allocations without Rebalancing](image)

In short, there’s a lot of twists and turns along the way without rebalancing. Often, rebalancing requires investors to do what is emotionally uncomfortable: buy low, sell high.

As Burton Malkiel said, "We all wish some genie could tell us when the stock market tops out so we could sell. Rebalancing is the closest technique available to do that."

Consistent rebalancing is a critical step in delivering strong client outcomes but can also be a considerable time-suck as well. Which is why sometimes, it’s better to offload to a third party.
The list above is not intended to be all-encompassing. There are many other reasons to outsource investment management, but all these ideas center around a key concept: free up advisor time to focus on clients.

David Booth — founder of Dimensional Funds, a firm that manages $540 billion across dozens of funds—often shares one story when discussing his career highlights. When investors were collectively withdrawing billions from equity markets during the financial crisis, his firm saw positive investment flows.

Why?

In his words:

“It wasn’t because our returns were better; we actually lost more than the market. But clients trusted us.”

There is no substitute for trust. There are many traits that make a strong financial advisor, but developing trust with clients is among the most desirable.

Does outsourcing investment management make clients trust you more? Of course not. But outsourcing the investment function does enable you to increase time spent with clients, deepening the relationship. The deeper the relationship, the more trust likely exists.

Peter Mallouk—CEO of Creative Planning, one of the largest RIAs in the country—recently gave an interview to Barron’s discussing trends in client growth, a big part of which comes from existing clients referring new clients, stating:

“Organic growth tells you whether your clients are getting what they want from you. Are you keeping your promises to your clients? Do they like your service? Do they like you enough to actually tell other people about it?”

The last point might be the most prescient. Creative Planning has more than 400 advisors throughout the country—and the fuel that makes its business go is strong client relationships, not driving alpha over a benchmark.

That doesn’t mean investment performance isn’t important—of course it is—but investments are like the gasoline in a car. They make the car go, but there are extra considerations—other passengers, brake pads, windshield wipers, and so on—that all factor into arriving at a destination safely.

Most clients likely won’t remember if their financial advisor beat a benchmark in any given year. But they will likely remember the communication, transparency, and your willingness to sit on the same side of the table.
One way—though certainly not the only way—to do that is by considering outsourcing investment management, enabling you to spend more time focusing on items clients hold dear.

And all this can go a long way in helping advisors close the behavior gap.

At Morningstar Wealth, our mission is to empower investor success, and we’re pleased to offer these resources to help you and your clients reach their financial goals.

Advocators who use model portfolios can often find more time to grow their practice, focus on what matters to prospects, and build stronger, lasting relationships with clients. Contact us to learn more about using model portfolios in your practice.

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Your investment goals matter to us. Our mission is to empower investor success by building investment portfolios selected by your financial advisor. Our world-class investment strategies draw on our core capabilities in research, asset allocation, investment selection and portfolio construction. Our investment professionals are located around the world, which provides both a global point of view and local market expertise.

Based on a proprietary valuation-driven asset allocation process, our strategies offer investors a range of multi-asset, risk- and outcome-based strategies designed to help meet a variety of goals. Also, our separately managed accounts offer concentrated portfolios of our portfolio managers' best ideas. We put more than 35 years of investment experience to work in every portfolio we manage to offer you a better investing experience, because your journey matters.

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