



# Personalization And The Post-Fund Future Of Investment Management

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Outside of investment management, I can't think of another industry with such a yawning chasm between its claims of personalization and actual personalization. Every major provider would seem to be a master tailor. As I surf the Internet, listen to the radio in my car – yes, I still do that – and even pass highway billboards, it's surround sound from my industry: "Customized just for you."

So, unless all the marketing departments are dead wrong, let's take it as a point of fact that financial end clients value the notion of personalization – even though we all know they're currently being sold cookie-cutter products.

And the clients are right. They may not be financial experts. But, it takes only simple intuition to realize that life is complicated and each of our lives is complicated in different ways. That's why clients seek an advisor in the first place. Each of them has their own situations, goals, and values.


For example, if an end client works at Google, she is highly exposed to Google's financial performance and the tech sector. She should therefore never own the same version of a strategy – whether passive or active – as someone else.

That's just a small example. Maybe her partner is switching sectors from finance to healthcare, and also holds a bunch of Apple stock in a brokerage account. Maybe she's worried about climate change (I am), and she would rather invest in clean tech than coal. On top of that, she would prefer the corporations she holds to not be making secret political contributions to candidates and causes she reviles. Plus, her account is taxable and she should be harvesting losses.

Yet, no one is ever going to market an S&P500-minus-Google ETF, let alone all these specific client configurations.

Until now, as an advisor, you couldn't go this "last mile." Instead, the only efficient way to construct portfolios was to use giant, prefabricated building blocks – mutual funds, ETFs, and models. As a result, nearly all end clients have existed off of their efficient frontier.

Now, let's imagine a different reality. You go into that client meeting and whip out an iPad. You input a strategic allocation mix using underlying benchmarks instead of funds. You then tap and slide the client's multiple values, select tax optimization, perhaps add factor tilts and other variables, show the client the proposal, and hit: "Go."



Thereafter, it's just software buying and trading directly in exchanges, to consistently maintain those benchmarks over time, while optimizing for the client's specific situation and values. This is what we call "Dynamic Custom Indexing." No fund manager, no expense ratios, maximum tax alpha.

As icing, especially for spouses and next-gen heirs, picture the social and environmental impacts the client has had on the world, thanks to you, updating in real-time on your dashboards and reports. E.g. "Congratulations - this quarter you planted X many trees, invested Y in curing the cancer that tormented your husband, creating Z number of jobs in your home state, and only funded corporate political contributions to your own party, which amounted to \$X dollars. Oh, and by the way, here's your financial performance."

Such a reality was infeasible until recently. But technology has made this not only possible but relatively easy.

Every so often, there is a major paradigm shift in asset management. The first issuance of public stock certificates. The mutual fund/commingled vehicles. And then the commoditization of those vehicles into ETFs.


We are all standing smack dab in the middle of the next one.

In the last two years, transaction fees went to zero. Now, our industry is being forced to question: What costs are we actually saving by pooling twenty million end clients into a cookie-cutter vehicle? Why couldn't each client have their own customized index fund or strategy built just for them? We also have supporting trends, such as fractional shares capability, the proliferation of ESG data, the active-to-passive shift, and a raft of APIs. All of which makes it easier and scalable to personalize, onboard, and implement for wealth clients of any size.

At the same time, fee compression is diminishing the value of the traditional product set, pushing the asset management industry to seek new sources of value. Through personalized direct indexing, a giant beacon of hope starts to emerge from the carnage: Opening up wide margins and boosting retention, while actually delivering more value to the client as well.

These enablers and incentives have reached a tipping point, and our industry is jolting forward.

If this feels hard to comprehend, you're not alone! If you were a record industry executive in 1998, and I told you CDs were going away, you would have a similar reaction. Like ETFs, CDs are super cool and modern and everyone loves them, right?



Yet it turns out the industry forgot the product is the underlying music, not the wrapper. Those records and CDs were the barriers to consumption, not the source of value. Most people don't want to go into record stores. And they don't want all the songs on the album. By digging in, rather than embracing Spotify, you're about to experience 20 years of pain.

Source: <https://www.ft.com/content/cd99b95e-d8ba-11e6-944b-e7eb37a6aa8e>

In the long run, streaming is saving the record industry and propelling it to unprecedented fortunes. Music has effectively transitioned from a product to a service. As I have written about previously, asset management will follow a similar trajectory.

Software can now "stream" benchmarks directly to advisor workstations, and financial advisors become the DJs for their clients. Manufacturing moves downstream to your fingertips. Now you can "3D print" portfolios for each client based on their individual goals, situation, and values.

In several years, if you try to sell me a mutual fund, it will be just as preposterous as trying to sell me a Pearl Jam CD.

This is all great news for advisors. You become the star of the show. Why? When digitization hits any industry, all the power and margins move to wherever there is a necessary remaining human relationship. The nexus of inter-subjectivity and trust. In our industry, that's the advisor-client relationship. Everything upstream of this goes to 1's and 0's and gets commodified.

Meanwhile, you can finally deliver on the value proposition the industry has been proffering all along: personalization. Manufacturing becomes the third leg of the stool, integrated with your advice and planning workflows.

Now you can take the most valuable asset in the entire financial services industry – your special knowledge of the client – and build it into the product itself. That's something that no one else – not Vanguard, not robos, not the guy up the street – can compete with.

Welcome to the Post-Fund Paradigm Shift. This time ... it's personal.

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