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An Evolving Model for Advisor-Directed Portfolio Management

Posted by Erik Preus - on November 29th, 2015

Growth of conventional "advisor-managed" portfolios has begun to slow as a new generation of advisors is changing the traditional model. Advisors see the signs of industry disruption on the horizon, and want to ensure their stake in the future. Some rightly question whether the best practices that worked in the past can support an aggressive growth posture going forward. Others wonder whether "business as usual" is even sustainable in a world becoming dominated by agile and automated competitors.

Both options present cause for concern. Handing over a function that is at the core of their professional identity—such as managing portfolios—may buy advisors some growth, but it can exact a high cost. They risk becoming personally irrelevant to their clients.

But activity among the fastest-growing advisors indicates that those concerns may be overstated. Advisors who outsource portfolio management have good reasons for doing so.[1] They are freeing up valuable resources that can unlock substantial value, leading to higher growth rates than those of advisors who still manage portfolios themselves. In fact, an impressive 72% of RIAs surveyed by Northern Trust credit their decision to outsource portfolio management as directly contributing to their growth.

Start-ups are leading the charge

Recent surveys among RIAs reveal that an outsourcing mentality already has reached critical mass within the industry. That means that advisors who keep everything in house are actually a minority in today's marketplace.

The numbers show a surprising number of advisors flirting with outsourcing peripheral functions while keeping an iron grip on what they consider their core business. For example, more than half of RIAs polled by WealthManagement.com now outsource tax preparation. But the numbers begin to slide in the shift from basic accounting and compliance toward portfolio management. At the level of performing raw investment research, 92% of RIAs still complete it in house[2].

The generation of advisors who still think asset management is their core business may cling to that notion, but it may not serve them going forward as investors come to expect holistic financial guidance that extends beyond portfolio management. What's striking is how rapidly newly chartered firms have recognized this and are forging the deepest outsourcing relationships they can negotiate. They're offloading many services, including human resources, trading, asset allocation, research, and portfolio management.

Their logic isn't difficult to follow: although advisors require these functions to operate, it may be less expensive and more efficient to rely on outside expertise than build it from scratch. And they aren't hampered by an organization legacy dictating pride of ownership.

Whether ambition or pure pragmatism drives advisors to outsource portfolio management, once they start down that path, they aren't changing course. Nor are they likely to revert to a more conventional in-house portfolio management structure as they grow.

Rather, these firms (and their numbers are increasing) don't consider in-house portfolio management to be part of their value proposition. And established firms are being pressured to restructure their processes to remain competitive. Firms who manage portfolios can always carve out a niche, but the clock is ticking as advisors either retire or merge with partners who have a broader view. In fact, several firms have had a key advisor either retire or leave, and the decision was made to cease offering in-house portfolio management, rather than bring in someone to assume that role.

Some capacity-constrained firms may evolve to a model in which advisors manage client relationships and outsource everything else, allocating resources toward acquiring new clients, rather than building assets under management.

Clients appreciate a broader value proposition

Client expectations may be evolving, too. Results of the Northern Trust study suggest that 56% of advisors consider their professional role to be that of portfolio managers. But only 2% of clients would consider a firm's decision not to offer in-house portfolio management as justification to leave the firm.[3] Those figures suggest that more than half of the advisors—54%—operate from a view of how an advisor's life "should" be structured, rather than what their clients may desire.

New firms that use an outsourced model are winning and retaining new business, evidence that clients may be content to pay an advisor they trust, even if the mechanics of portfolio management rest with a third party. Their comfort level isn't likely to deteriorate as that model becomes more widespread.

That may be because clients perceive enormous value from advisors who are free to spend more time and energy on other functions—tax efficiency, financial planning, and holistic wealth management. And that's where savvy advisors can shine—by embracing the change. Listening to their clients, looking at the big picture, being proactive as their needs change, and giving them more personal attention is a recipe that can deliver significant benefits.[4] Advisors will be rewarded with appreciative, close, and loyal clients, who will consider the fees they pay to be more than justified.

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[1] Northern Trust 2014, "Investment Management Outsourcing: Impact on Clients".

[2] WealthManagement.com, "2015 AdvisorBenchmarking All-Channel Report".

[3] Northern Trust 2014, "Investment Management Outsourcing: Impact on Clients".

[4] Morningstar, June 2015, "Five Ways Investment Management Outsourcing Can Grow Your Practice".

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