

PRACTICE MANAGEMENT

SELF Improvement

Advisors intend to make improvements to their practices this year

BY MAYA IVANOVA

WHAT ARE ADVISORS' GOALS TODAY? Improving business practices and investment knowledge, connecting with clients in a more challenging market, and making more tactical/opportunistic investments were the three top areas of focus for most of the investment advisors who participated in a recent supplement to the 2005 Rydex AdvisorBenchmarking Survey.

This year's survey measured advisor views on a broad range of issues—from technology investments to the direction of interest rates, from down-market strategies to definitions of business success. As usual, advisors operating in the increasingly competitive financial services industry environment are not content to rest with the status quo.

It should come as no surprise that, as a group, advisors are keenly focused on improving business plans, processes, and investment skills in order to raise assets and retain their more profitable clients.

All advisors surveyed indicated that they had some clearly identified goals for self-improvement. Thirty-eight percent of registered investment advisors (RIAs) rate technology reports/data access as their top self-improvement goal for 2006 (see "Areas to Improve" chart on opposite page).

Advisors highly rank the need for improved access to product information, reporting capabilities, and associated data storage and retrieval systems. Although paper proliferation exists in every industry, relatively few advisors have decided to go paperless so far. Those who have taken this step reportedly realize significant savings in staff time, file cabinets, and office space. For many advisory firms, investments in online research databases, scanning technologies, and secure networks have helped create much more efficient investment processes.

Focus on high-net-worth clients. Thirty-one percent of advisors rate increasing their knowledge of issues unique to high-net-

worth (HNW) investors as a top goal. Advisors are sensitive to clients' needs for comprehensive estate, tax, and business succession planning, as well as exposure to absolute return investing, alternative asset classes, downside risk protection and charitable giving vehicles. Forming partnerships and alliances with other professionals who have specialized expertise in these areas has become critical to managing the growth in financial advisory practices.

Harness more investment products. Despite years of predictions that the financial services industry would undergo significant consolidation due to its maturity, advisors must contend with an ever-increasing array of products. Some advisors seem eager to deploy the best of these new offerings in their portfolios. In fact, offering clients a wider, better range of products ranked as a number three goal, cited by 23% of the survey respondents.

Choices available to individual investors have moved far beyond traditional long-only stock, bond, and mutual fund portfolios to encompass annuities, exchange-traded funds (ETFs), indexed equity and fixed-income products, hedge funds, "pure" currency plays, and sophisticated tactical asset allocation programs, and inverse strategies.

AdvisorBenchmarking, a research and analysis center focused on the RIA marketplace, conducted the online survey in mid-November 2005 to supplement its sixth annual Rydex AdvisorBenchmarking study, "The RIA Industry: Positioned for Continued Growth," a survey of 353 registered investment advisors conducted online between March and June 2005. For the supplemental survey, AdvisorBenchmarking polled 257 advisors on their views of investment and practice management issues. The complete report is available from Maya Ivanova at 301-296-5385, or via e-mail at mivanova@advisorbenchmarking.com.

Advisors are increasingly interested in gaining a better understanding of how these products can be integrated into portfolios.

Less interest in educating clients. Somewhat paradoxically, a scant 8% of advisors want to improve their skills in investor education, by offering effective seminars or one-on-one sessions focused on themes of particular interest to clients, which typically are understood to include specialized investment products, income distribution options, wealth protection strategies, and portfolio diversification using non-correlated asset classes.

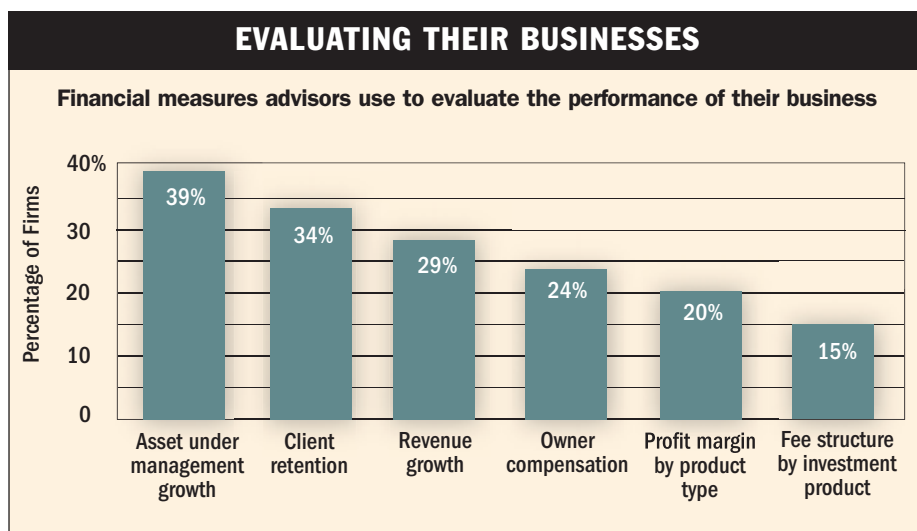
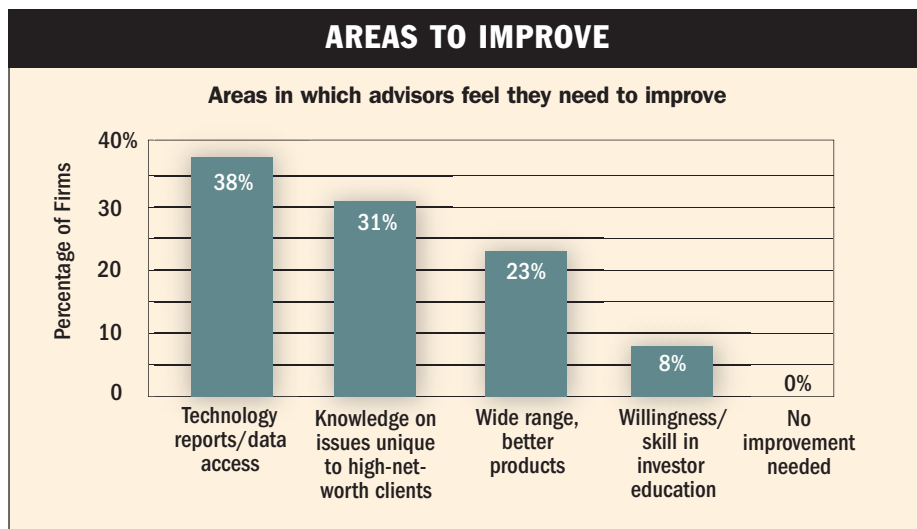
It's clear from other recent research that advisors need to play an educational role for clients, particularly in the area of specialized investments. In a June 2005 Rydex investor survey, 42% of the respondents had never heard of inverse mutual funds and 29% didn't know what ETFs were. Twenty-six percent had never heard of sector funds. The most consistent reason investors gave for not investing in specialized products was that they didn't know enough about them.

Checking vitals for a healthy business. When it's time to review financial performance, most advisors look at assets under management growth (39%), client retention (34%), and revenue growth (29%) to assess the state of their businesses (see "Evaluating Their Businesses" chart, at right).

A Growing Disconnect

Operating in an increasingly complex and challenging investment climate, advisors expressed a need to be more in sync with clients in terms of shared views about markets and investment strategies. When AdvisorBenchmarking compared the results of similarly constructed and tracked advisor and investor surveys, we uncovered a number of instances in which advisors and their clients have surprisingly divergent views—interest rates in a post-Greenspan world and asset allocation strategies. These gaps could have a significant effect on the long-term health of advisor-client relationships.

The post-Greenspan world. When advisors and their clients speculated on interest rate policy in a post-Greenspan world, there was a marked difference in expectations. While nearly half (44%) of clients somewhat or strongly agreed that the departure of Federal Reserve Chairman Alan Greenspan will cause a dramatic increase of interest rates (see "Clients' Expectations on Rates" chart, page 84), a near majority of advisors surveyed (46%) neither agreed nor disagreed



that interest rates will increase dramatically (see "Advisors' Expectations on Rates" chart, page 84).

Only 23% of the advisors surveyed somewhat or strongly agreed that interest rates will increase dramatically. Advisors may find it beneficial to communicate their reasoning behind their views on this topic with their clients, as evidently many clients have a decidedly different take on a fundamental threshold issue affecting their portfolios.

Use of traditional asset allocation strategies. The majority of RIAs surveyed (63%) said that allocating among the three main asset classes—equities, fixed income, and cash—can provide adequate diversification for their clients. Nevertheless, our investor survey showed that only one in four (23%) has a formal asset allocation strategy in place. The remaining respondents (57%) use an informal strategy or no asset allocation strategy at all. This suggests a wide chasm between advisors and investors on why asset allocation strategies are important.

More Tactical, More Opportunistic Approaches

While all advisors use a wide array of investment strategies to manage day-to-day portfolios, most of those surveyed expressed interest in using more targeted strategies to eke out incremental returns or manage various risk exposures in future sideways or down markets.

Ranking strategies if interest rates rise. Of the 23% of advisors mentioned earlier who strongly or somewhat agree that interest rates will increase dramatically, they all have different approaches to protect their fixed-income investments. Forty-five percent would sell fixed-income holdings that are most sensitive to interest rate movements, such as interest-rate sensitive stocks, 20- or 30-year bonds, or certain mortgage-based fixed income holdings. Twenty-five percent would shorten average maturity of fixed-income holdings, 16% would shorten average maturity of fixed-income holdings, and just 8% would utilize an inverse bond mutual fund product.

Keeping up with down markets. In a mar-

ket downturn, most advisors tend to make changes to their portfolios to minimize losses and risk. Almost half of advisors (46%) try to do this by purchasing non-correlated assets. Thirty-two percent of the financial professionals surveyed continued to invest (or dollar cost average), 25% of advisors use shorting strategies (other than stocks), 10% use leveraged and inverse investments, 7% short individual stocks, and 8% purchase index put options.

Only 11% of the investors surveyed indicated they would use inverse funds, leveraged funds and hedging strategies to seek to benefit from market downturns. If advisors are to make effective use of these techniques in managing client assets, additional educational work likely will need to be done to raise clients' comfort levels.

Using economic factors as part of client planning. During the investment planning process for clients, almost all of the advisors (99%) factor in current interest rates, oil prices, and real estate values. According to the majority of advisors surveyed (85%), the present energy crisis has not significantly affected their clients' approach to investing.

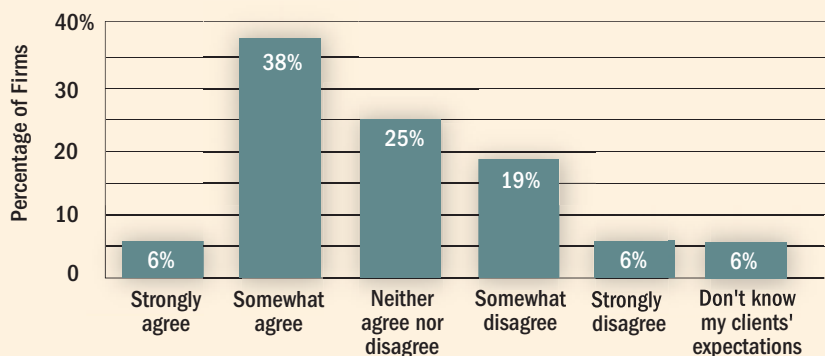
A majority of advisors (63%) reportedly meet with clients to readjust their portfolios based on market conditions, rather than on a calendar basis (25% reported quarterly meetings; 13% monthly client meetings). Making more frequent adjustments to an asset allocation strategy than traditional asset allocation approaches is generally perceived as a superior way to optimize the risk-reward characteristics of client portfolios. Nevertheless, trading costs and tax ramifications must be considered when following a more frequent rebalancing approach.

Final Thoughts

To get to the next level, many advisors recognize that simply maintaining the status quo is not enough. They're continuously examining their business plans and investment processes to look for improvements. They're clearly becoming more opportunistic in their investments. On the other hand, average investors may not yet understand

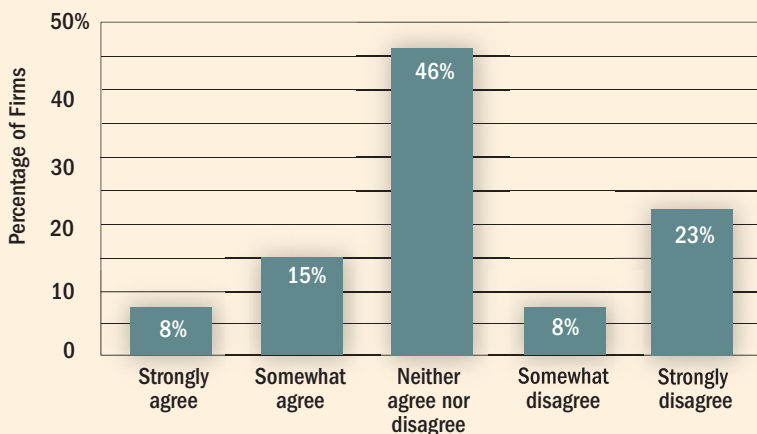
CLIENTS' EXPECTATIONS ON RATES

Clients' expectations for interest rates to increase dramatically with Alan Greenspan's departure



ADVISORS' EXPECTATIONS ON RATES

Advisors' expectations for interest rates to increase dramatically with Alan Greenspan's departure



how these approaches may prove to be beneficial in growing and protecting wealth in different market environments.

Advisors plainly need to close the knowledge gap with clients—through better education and more aligned expectations—if they are to increase their level of client retention and new referrals. Surprising differences have emerged between advisor and client perceptions of the investment climate, as well as the deployment of available alternative strategies and techniques that can be used to manage risk in up and down mar-

kets. Ultimately, we believe the biggest area for advisor focus in 2006 may well be in client education and client service. **IA**

Maya Ivanova is a research analyst at Rydex AdvisorBenchmarking and can be reached at mivanova@advisorbenchmarking.com. AdvisorBenchmarking is research and analysis center focusing on the RIA marketplace. AdvisorBenchmarking is a service of Rydex AdvisorBenchmarking, Inc., an affiliate of Rydex Investments.

The analysis on Rydex AdvisorBenchmarking is based on the number of completed surveys and reflects only information from these surveys. This information is intended to be general and these overviews are no substitute for professional, legal or consulting advice. This information should not be construed as advice from Rydex AdvisorBenchmarking, Inc., AdvisorBenchmarking.com, its strategic partners or their affiliates. AdvisorBenchmarking.com is a service of Rydex AdvisorBenchmarking, Inc., an affiliate of Rydex Investments.

INVESTMENT ADVISOR™ (ISSN 1069-1731) is published monthly by Wicks Business Information, L.L.C., 1161 Broad Street, Suite 200, Shrewsbury, NJ 07702. Tel: 732-389-8700. Periodical postage paid at Red Bank, NJ, and additional mailing offices. Subscription Rate: \$79 per year. POSTMASTER: Send all subscription orders, changes of address, and correspondence to Investment Advisor, P.O. Box 2162, Skokie, IL 60077. ©Copyright 2006 by Wicks Business Information, L.L.C. Reproduction, photocopying, or incorporation into any information retrieval system for external or internal use is prohibited unless permission is obtained beforehand from the publisher in each case for a specific article. The subscription fee entitles the subscriber to one original only. Unauthorized copying is considered theft. The publication is designed to provide accurate and authoritative information in regard to the subject matter. It is sold with the understanding that the publisher is not engaged in rendering investment advisory, legal, or accounting services. If such assistance is required, seek the advice of a competent professional.