



Tiburon CEO Summit XIV: Chip Roame: “The News is Noise”

April 15, 2008

Tiburon Strategic Advisors held its CEO Summit XIV conference on April 11-12. This event attracts approximately 150 attendees, most of whom are CEOs or senior operating officers from mutual fund, financial advisory, brokerage and custodial firms. It was held in New York for the first time, after being held in prior years in San Francisco.

Chip Roame, Tiburon’s Managing Principal, delivered the opening keynote presentation, and offered Tiburon’s assessment of important events and trends in the financial services industry:

- Roame characterized the significant events of the last year, including sub-prime write-offs, Bear Stearns, sovereign wealth funds, Wall Street layoffs, and the collapse of the private equity industry as “noise.” The significant, lasting event of the prior year is the impact of declining real estate values on baby boomer liquefaction and retirement strategies.
- The decline in housing prices presents a significant challenge to the way in which baby boomers have “saved” for retirement. Baby boomers have saved for their retirements by assuming that they would liquefy the equity in their houses, and declining home values demonstrates that “this strategy is not working any more,” says Roame.
- Only 21% of baby boomers over age 55 have investable assets greater than \$100,000. Consumer household personal savings has been negative for the last three years (-\$34.8Bn in 2005, -\$96.4Bn in 2006, and -\$82.3Bn in 2007), after having been in excess of \$130Bn for the four years starting in 2001. Only 2% of baby boomers will inherit greater than \$100,000.
- The challenge facing baby boomers is compounded by increasing life expectancy. The average American lives to 77.5 but, as Roame notes “this really doesn’t matter – what matters is when you retire.” The life expectancy of someone reaching age 65 is now 87, and this is the metric against which the retirement industry must plan.
- For 90% of the households, health care and retirement savings are the twin challenges,” says Roame, adding “only 10% of households are focused on charitable giving.”



- “The next wave of investors is the retiring baby boomers, and many will not have investment experience,” says Roame, adding “they may be uninformed and will be influenced by brand names.” The challenge for the independent industry is to achieve differentiation against the wirehouse and commercial banking segments.
- Roame predicted continued, significant sub-prime-related write-offs from the financial services industry, and cited flawed compensation systems as an underlying cause. Roame said, “I am afraid the investment banking compensation system incents executives to take extreme risks (moral hazard). Just think back to the bonuses in the good years; do they give those back? Then why not take another big risk?”
- The total amount of investable assets held by consumer households is now \$22.8 trillion, of which \$13 trillion is held in retirement accounts. Since this represents the market size of the financial services industry, Roame notes that no single player has significant market share. Financial services is a fragmented industry, and even the largest players have market shares less than 2%.
- The mutual fund industry, with assets close to \$11 trillion, dwarfs all other investment products. “The mutual fund industry will be here for a long time,” says Roame, in response to those that forecast its demise. Although some products, such as ETFs, are experiencing significant growth in percentage terms, they are a long way from catching the mutual fund industry in absolute terms. The inflexion point for mutual fund growth was when they penetrated 401(k) accounts, and it will take a development of similar magnitude to accelerate the ETF markets.
- Roame is a “naysayer” on target date funds. He believes these funds are being misused, as retirees are holding additional funds (primarily equity funds), resulting in sub-optimal overall asset allocations. He said target date funds “are a nice idea, but they are not being used correctly.”
- Packaged fee accounts have grown substantially over the past eight years, to \$1.5 trillion in assets. Roame forecasts these becoming increasingly popular as baby boomers retire and liquefy their assets into these accounts.
- Roame pegged the U.S. hedge fund industry at \$1.9 trillion, larger than the ETF and SMA markets combined. “Hedge funds are by far the most profitable segment of the industry, making more than the rest of the



industry added together,” says Roame, although this was qualified by the fact that much of this profit is in the form of carried interest.

- There are approximately 400,000 financial advisors in the U.S. today, divided roughly equally across four segments: 22% are independent reps, 22% are bank brokers and trust officers, 23% are wirehouse and brokerage representatives, and 23% are life and property & casualty agents. Only 8% (30,024) are partners at fee-only financial advisory firms, although this segment has had the highest growth rate in AUM (18% annually over the last 12 years) of any channel. The final 2% are discount broker and mutual fund representatives. There are no significant flows, when measured by numbers of people, between these channels. However, when measured by AUM, there may be significant flows from captive to independent and fee-only channels, as those reps that do move may bring with them disproportionately larger assets.
- The advisory business is highly competitive, particularly with respect to the larger and more profitable accounts. 400,000 advisors are competing for the business of approximately 117 million households (an average of 300 households per advisor). These households have average investable assets of \$210,000, but the median investable assets are only \$8,100. Advisors are competing for the business of only the top 10% or 20% of households, or between 10 and 30 million households, which works out to only 50 accounts per advisor.

We will provide additional coverage of the Tiburon conference in next week’s issue.

Our Analysis

Roame’s characterization of the past year’s events as “noise,” with effects limited to the liquefaction of baby boomer retirement assets, understates the scope of the sub-prime crisis. Roame’s assessment will be correct if there are no further significant declines in housing prices, the equity markets have already discounted most of the bad news, and we undergo an eight month recession, similar to the prior two recessions. However, as we have noted in prior [analyses](#), we believe the sub-prime crisis has the potential to be far more extensive than prior crises faced by the US markets, and we are not convinced future bad news (which Roame agrees is forthcoming) is fully discounted by the markets. Housing prices could decline by another 30% (see graph on this [page](#)) and evidence from other countries (see our [article](#) on this subject) suggests a two- or three-year recession. A prolonged recession, combined with current low interest rates and further declines in housing prices and equity markets, will



affect more than just baby boomer retirement assets. Retirees at or near the de-accumulation phase will see an immediate impact, and Gen-x and Gen-y investors will suffer significant erosion in their retirement assets. This is more than just “noise.”

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