Three Trends That Will Change the Game for Advisors

By Steve Lockshin
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This article is excerpted from Steve Lockshin's new book, Get Wise to Your Advisor*, available from the link above. This book makes an impassioned argument as to why clients should choose independent advisors who adhere to a fiduciary standard. The book also contains a checklist that clients can use to evaluate a prospective advisor; Steve has made this checklist available to our readers here.*

Twenty years ago, if you wanted to buy a book or a pair of shoes, you went to a store, made your purchase and drove home. From time to time, you might order something from a catalog – a power tool perhaps, or a pair of pajamas. Back then, most of us simply could not conceive of another way to shop.

But while you and I were schlepping to Sears to buy a new vacuum cleaner or a six-pack of socks, a former hedge fund executive named Jeff Bezos was working out of his garage, starting the company that would become Amazon.com.

A couple of decades ago, electric cars existed only in science fiction. Today, tens of thousands of hybrid gas/electric cars are on the road, and pure electric cars are a reality. Elon Musk, probably the best-known champion of electric cars and the founder of Tesla, is also spearheading an effort to develop civilian space travel capabilities. Richard Branson, of Virgin Airlines fame, is doing the same.

> Amazon today is a $100 billion empire that has revolutionized the way we buy books, tools, toys and just about everything else. Bezos has been hailed by *Fortune* magazine as the "ultimate disruptor." And Sears and all the other retailers who have been disrupted have been scrambling to catch up.

Discount online brokerage revolutionized the financial industry in the 1970s, and software-based investing is pushing the envelope even further today. Look at what Steve Jobs did in only a few years with the iPad and iPhone. The world is changing at an ever-accelerating pace.

Take a step back and you'll see that the list of services and goods that have moved from fantasy to reality in the past decade is impressive. That's why I believe that, even though the advisory world of today seems to be locked into the same old flavors when it comes to pricing, new items will soon be on the menu. That change will likely be here before most of the industry is able to react.

The change that is coming to financial services pricing isn't as sexy as space travel. It won't give you an ice cream sugar high or even satisfy your cravings. But as a practical matter, it will make a huge difference in your family's financial wellbeing.

New ways of doing things will emerge because visionaries within the industry have shown that they are possible, and because consumers at every level along the wealth spectrum ultimately will vote with their dollars for progress, transparency and fair pricing.

I predict that in less than a decade, the following changes will be firmly in place:

1. Separation of value services from commodity services

Once upon a time, airline travel was a luxury reserved for the well to do. Today, with numerous airlines competing for your business, air travel is the standard way to traverse long distances, and it's available to virtually everyone. In other words, air travel has become a commodity, and pricing (and the ability to shop online for flights based on price) reflects this change.

The world of financial advice has its commodities, too. They include guidance about which investments to buy and how to mix different types of asset classes within your portfolio. These aspects of financial advice (i.e., asset allocation and fund/manager/stock selection) are now standard across the industry. They should be assigned relatively low cost to reflect the fact that they are commodity services. I submit that if you line up the top 50, 100 or even 500 firms and gave them the same client to plan for, 20 years from now the investment portfolio results would be amazingly similar.

The data suggests that there are few consistent, outstanding stock pickers and investment fund managers – so few that they are as uncommon as airplane crashes. Warren Buffett is one of those outstanding asset managers, and everyone knows Warren Buffett's name because he is one of a kind. He is (when it comes to newsworthiness) the equivalent of a space shuttle disaster – it almost never happens. However, the manager of a middle-of-the-pack mutual fund is the equivalent of an on-time JetBlue departure (snore).

On the other hand, the best advisors – the top decile – deliver an enormous amount of value when they provide un-conflicted and customized guidance and information about complex financial planning, taxes and estate-planning situations. They provide value when they keep you from making imprudent decisions. This kind of advice is a world away from being a commodity.

A great advisor and a run-of-the-mill advisor will often provide pretty much the same commodity when it comes to asset allocation and investment recommendations. But a truly excellent advisor can add quantum value to your family's net worth through the non-commodity of quality advice.

Today, pricing does not reflect the commodity-services/value-services divide. An advisor might provide asset allocation and investment recommendations to one client and complex advice to another and charge them the same fee. But before long, the consumer who buys a commodity service will pay less, and the consumer who receives a value service will pay a value-oriented fee.

As pricing shifts to reflect the specific level of complexity and risk within an advisor-client relationship, the rigid vanilla/chocolate/strawberry model will start to melt away. Pricing will become clear and straightforward – more like the pricing in a grocery store. Both commodity services and value services will have clear price tags. They won't be mixed together and assigned an arbitrary price.

2. A Focus on un-conflicted advice from capable fiduciaries

Consumers will increasingly appreciate and demand the services of advisors who are capable, whose advice is unbiased and who are fiduciaries. And they will ultimately be able to tell the difference. As I suggested earlier, people who sell products should be clearly identified and people who provide only advice clearly delineated. (You may recall that I suggested people with conflicts should be called brokers and true fiduciaries should be called advisors.)

Today, the brokerage model is still dominant in the financial advice industry. But the winds of change are already starting to blow. In recent years, hundreds if not thousands of advisors have left the conflicted world of brokerage firms to become independent registered investment advisors (RIAs) in order to better serve clients.

And clients have been yanking their money from marquee-name brokerage firms like UBS, Merrill Lynch, Wells Fargo and Morgan Stanley Smith Barney and moving it to RIAs with much lower profiles. As I explained previously, while RIA firms don't have a fraction of the visibility that the dominant brokerages do, this is likely to change. Today, the industry is made up of over 15,000 independent firms, and that makes for a serious marketing challenge. Too few people know the difference between brokers and fiduciaries such as RIAs. And even fewer can tell the capable, true fiduciaries from those posing as such. However, information technology can rapidly change this. And many fiduciary advisors are trying to get the word out on what it means to do the right thing.

But the main reason I'm confident that fiduciaries are the future is because I have faith in the American consumer. Conflicted, self-serving non-fiduciaries will only be able to beguile consumers for so long. Eventually investors large and small will see through the slick marketing campaigns and glossy brochures of golden retrievers and sailboats and decide that they deserve solid, objective advice from able practitioners who are sworn to put clients' interests first.

3. Partner firms that empower consumers will emerge

As the vanilla/chocolate/strawberry status quo is replaced by a marketplace full of options and flexibility, a brand new category of fiduciaries will spring up to help consumers make the best choices.

These partner firms will help you to figure out which model you need, which advisor or resource to go to and how much you should be paying. The best partner firms will not only recommend investment partners but will audit advisors to ensure that they are highly qualified, highly professional and committed to your interests first and foremost.

This new breed of firm will represent a major evolutionary step in the financial services industry. Until the early 1990s, professional investment advice was almost exclusively provided through brokers. As consultants and "managers of managers" became popular, the number of independent advisors skyrocketed. Those independent advisors stood between the brokerage firms and custodians that housed and handled investment portfolios and transactions, as well as between the asset managers who ran mutual funds and separately managed accounts and other products.

The emerging firm of the future will oversee the tens of thousands of RIAs, brokers and other advisors who all claim to be the best partner for you, segregating these firms by the qualities that best meet your needs. The new, pure fiduciary advisors will provide un-conflicted, expert financial planning and tax and estate advice. These new firms will help steer you through the cluttered and confusing landscape to find exactly the advisor you need to execute the more commoditized portion of the plan – asset allocation and manager selection.

Why wait?

The nice thing about change in the financial services industry is that, just like an electric car, consumers can drive it, starting now. Consumers can urge Elon Musk or Richard Branson to hurry up and develop civilian spacecraft, but that probably won't speed up the process. However, if consumers throw their weight around with advisors – demanding to be treated fairly with respect to conflicts and pricing – advisors will acquiesce.

Imagine a client with a $100 million portfolio sitting down with his advisor and explaining that, while he appreciates that the advisor charges 0.75% annually against his assets under management, that's not the way he wants to pay for the service. Do you think that advisor would show his $100-million, low-maintenance client the door? Or would he suggest a conversation about a more customized approach?

I know for a fact that a number of firms are researching ways to charge clients based on complexity and risk rather than using the rigid old formulas. The more consumers demand this change, the faster the industry will adopt it.

And this doesn't just go for ultra-wealthy people. Even investors whom many advisors see as too small can shape the future of the industry through the choices they make. Why not ditch your advisor and use an ultra-low-cost software-based investing service such as Wealthfront or Betterment (I'm an investor in the latter)?

Those sites handle asset allocation and investment selection – commodity services, if you'll recall – for low, commodity-like prices. If your advisor isn't giving you value-added guidance on top of his or her commodity advice, consider making the jump and saving money. If your advisor is really adding value, let's say by keeping you from making financial decisions that you know are counterproductive, then that's another story. But as we've discussed, too many advisors are yes-men*,* content to collect fees and acquiesce to whatever their clients want. They are simply overpriced gatekeepers to the over-hyped mysterious world of manager selection and asset allocation.

A funny thing happens when consumers refuse to overpay. They can change the very way that industries do business. Consumer power is behind the success of Walmart and other big-box stores that, like Amazon, have disrupted the old, more-expensive department store model. It's behind the success of discount brokerages like Charles Schwab and E*Trade. And I'm convinced that consumers will help speed the change that's coming to the financial advice industry.

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