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EXPECT TO WORK HARDER

Advisors need to communicate with clients more and provide them with more active portfolio management.

By Timothy P. McGrath

The events of the past few years have taught us that as advisors, we must be more active with our clients, who need more attention than ever. We will have to work even harder to help them reassess their financial circumstances and goals.

Even high-net-worth clients, despite their financial resilience and substantial accumulated wealth, need to re-evaluate their investment, retirement and legacy considerations. For advisors, this means more frequent client contact, candid conversations and more active portfolio management.

Tactical Adjustments

The increasing number of global events potentially affecting the investment markets means advisors must spend more time researching in order to provide the best advice to clients. We have to be constantly searching for opportunities to move in and out of mispriced assets created by global developments. Capitalizing on these opportunities in a rapidly changing market environment will require more tactical adjustments to client portfolios.

While these opportunities may have existed earlier in the decade, the blowup of 2008-2009 has triggered greater disparity between different asset classes. There are more opportunities today to successfully overweight an asset category than in the past because of pricing disparity.

Exploring new investment opportunities will require an even greater level of due diligence. A more expansive and exhaustive effort is needed to implement the tactical adjustments pivotal to active portfolio strategies. In addition, each individual client situation must be evaluated to determine the most tax-efficient way to implement the strategies across qualified and non-qualified accounts, including workplace retirement plans.

Advisors typically choose between two approaches to implement portfolio management in their practice. The first is the more convenient, less laborious approach of simply dropping all client portfolios into a prefabricated model determined by the advisor or his firm. While the mix may vary due to divergent client risk tolerances, clients are uniformly compartmented into the same underlying investments.

Typically, the entire process is automated. When changes are necessary, the advisor need not act; the system makes the changes.

This approach frees up time otherwise spent on research, economic and market analysis and generally acquiring more detailed investment knowledge. It also requires less client contact and consequently is the more popular method for the majority of advisors. It's certainly an understandable choice for advisors who want more time for client acquisition or those who prefer to delegate portfolio management to others.

While the simpler model can utilize vehicles such as separate account management to employ tax-sensitive or other targeted strategies, it lacks the ability to incorporate the client's complete financial picture. It cannot provide a comprehensive, across-the-board perspective for each individual client, something critically important for high-net-worth clients. If an alternative component needs to be implemented, for example, where is the best place to do it? How will the addition meld with the client's other assets and tax considerations? What will be most efficient in terms of the client's overarching financial picture?

The alternative approach for advisors is to assess each client circumstance separately in order to arrive at an individualized allocation. There may be themes woven throughout the practice, but clients each receive their own implementation. Working with high-net-worth clients, I have found this approach to be preferable, since these individuals have outside assets, concentrated employer stock holdings and other special circumstances that must be considered.

The process involves selecting investments, deciding what to sell in order to raise funds for the purchase, identifying the best location for the investment (including employer-sponsored plans), and then taking into account any individual client circumstance that may impact implementation.

Individual tax situations differ greatly among high-net-worth clients, and there are a lot of moving pieces that require an individualized approach. While this means more work for advisors, explaining how the changes are implemented also provides additional opportunities for increased client contact.

Not every advisor who would like to adopt this approach is in a position to do so. The methodology requires frequent trades and individualized implementation plans; the downside is that it's not practical unless an advisor has a small base of high-net-worth clients and a support staff capable of implementing complex strategies.

Assessing Changing Client Circumstances

With all that has gone on over the past four years, it is our responsibility as advisors to help clients reassess their financial circumstances and objectives, make appropriate tactical portfolio adjustments and help them regain confidence in their investment approach.

Clients today have a renewed interest in the “nuts and bolts” construction of their portfolios. Increased media coverage of global events and their impact on market volatility also contributes to more intensive client questioning. I believe it is a positive development for advisors and the financial services industry. We become better advisors when we can explain the rationale behind our approach and how what we are doing helps clients become more comfortable with their investments.

Everyone suffered a significant hit to his or her financial plans as a result of the financial crisis. Lives have been changed, and while the financial impact may not have been as overwhelming for most high-net-worth clients, they have nonetheless been seriously affected. Their homes are worth far less, with home equity eroded or disappeared, their positions or professions may now pay less, they may not be getting expected bonuses and their 401(k) and investment accounts have shrunk.

Given this interruption of their financial well-being, clients must be made to understand that a paradigm shift may have to occur in the way they view their future. They need to take a step back and reassess their circumstances. As advisors, we have to facilitate this fundamental change in how they think.

We need to have hard conversations with them regarding the long-term impact of their diminished financial situation. Can they still retire as planned at age 45 or 50 or will they have to work longer? Will their investable assets still generate sufficient cash flow or will they have to adjust to a lesser lifestyle in retirement? Will they have to amend their estate plan or gifting wishes for their heirs or favorite charity? Can they still help send all their grandchildren to college?

These can be agonizing decisions, and it's vital for advisors to openly address how this new reality will affect the lives, financial objectives and future plans of their clients. We are currently engaged in difficult conversations with clients about whether their goals are still realistic and whether changes might be necessary in

order to meet them. Clients must understand this new environment and how it will continue to affect them.

Although these conversations are challenging, they are absolutely necessary to a successful client-advisor relationship. If we are to be true advisors to our clients, we are obligated to tell them what they need to hear, not what they would like to hear.

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