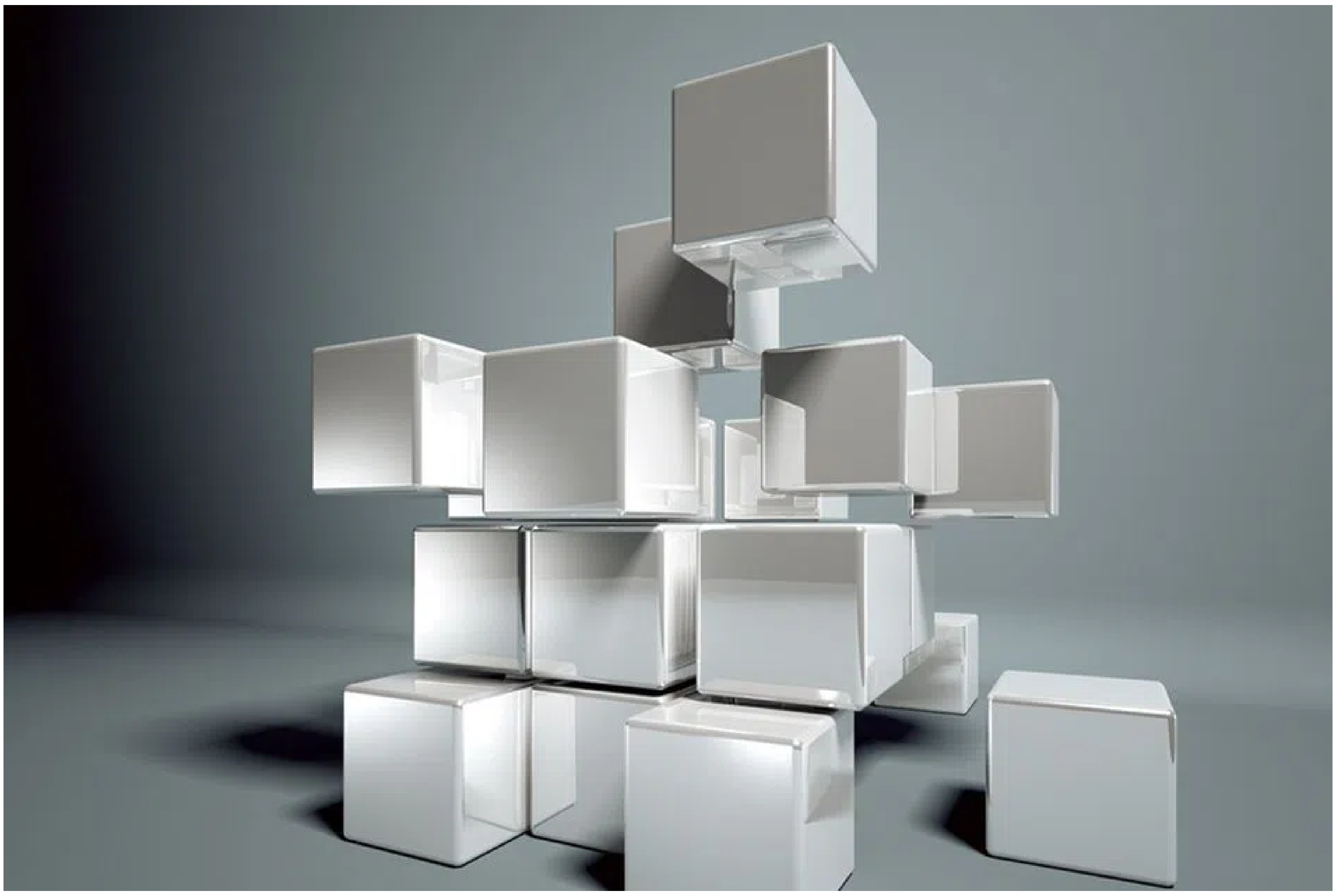
Advice industry tilts toward model portfolios as surest path to building scale



Client-level investment management is gradually going the way of white tennis balls as asset management becomes increasingly commoditized.

October 12, 2022 *By Jeff Benjamin*

As portfolio management becomes increasingly commoditized, the use of model portfolios is seen as the surest way to ***gain scale at the firm level***.

A new report from ***Cerulli Associates*** cites the trend toward a planning-oriented service model as "a powerful impetus for the adoption of model portfolios."

The driving force favoring model portfolios comes down to time management, according to Brad Bruenell, associate analyst at Cerulli.

By his calculations, advisory practices that are customizing portfolios on a per-client basis spend on average 29.5% of their time focused on investment management.

Those firms applying practice-level resources to build a series of custom portfolio models spend on average 18.5% of their time on investment management.

"This saved time can be put toward client-facing activities, which is a particularly important activity, for example, for younger advisers that are focused on asset gathering and building a book of business," Bruenell said.

While it might seem like a slam dunk to just embrace models either in-house or ***outsource investment management*** altogether, nothing is that simple, according to Vance Barse, founder of Your Dedicated Fiduciary.

"From a business management perspective it makes sense to scale the asset management, but when it comes to servicing clients my view is models aren't necessarily in the client's best interest when it comes to taxable accounts because that portfolio should be managed unique to each client's tax profile," he said. "I don't know how advisers can scale without model portfolios, but when you consider the extra time and efficiency standpoint, it makes more sense to outsource, and that's what a lot of advisers do because they're in the business of gathering assets. Bottom line, financial advisers should be managing taxable accounts."

Tim Holsworth, president of AHP Financial, also sees a time and place for models and outsourced investment management.

"We'll develop our own portfolios with ETFs and mutual funds, but when we use individual stocks we tend to go to separate managers," he said. "I'm a big fan of that for portfolios with $300,000 or more to invest because you typically want $100,000 minimum with each manager."

Holsworth said clients typically pay about 35 basis points for the separately managed account.

"It's more efficient, more personal attention, better return overall, and you don't have to worry about embedded gains and people liquidating and all the problems that come with a fund," he added.

The Cerulli report acknowledges various levels of investment management outsourcing and in-house model portfolios.

"The effective use of model portfolios can increase adviser efficiencies and service offerings in both maturing and fully mature practices in a variety of ways depending upon the preference of the practice," Bruenell said. "We anticipate this trend will continue to gain traction among advisers in the future as they seek to improve their scale and service differentiation."

Paul Schatz, president of Heritage Capital, said all signs point toward increased use of model portfolios and outsourced asset management. But he isn't convinced it's the only way to work with clients.

"The trend is definitely moving towards outsourcing portfolio management because it has totally been commoditized," he said. "While it's not free, it's awfully close. Many or most RIAs and brokers realize they are better at being a financial concierge, cruise director or quarterback than managing the actual assets. Offloading this allows advisers to focus on client acquisition, servicing and retention. My sense is that home offices also prefer this from a compliance standpoint. Like most things in the industry, this will continue until there is another sea change and the pendulum swings back."

Kashif Ahmed, president of American Private Wealth, said simplifying portfolio management is key to being able to focus on the ***broader business of financial planning***.

"The fact is most advisers are pivoting to delivering financial planning, and not just focused on investment management," he said. "As talented as any adviser is, the reality is they are not as capable at the investment selection, ongoing management and rebalancing as an entity that exists solely for this purpose. There really is no reason for an individual adviser to be doing this."

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