

The evolution of Vanguard Advisor's Alpha[®]: From portfolios to people

Vanguard Research

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Donald G. Bennyhoff, CFA; Francis M. Kinniry Jr., CFA; and Michael A. DiJoseph, CFA

- Trends in the investment advice industry—regulation, fees, and technology-enabled competition—likely will continue to shape the contours of the advice industry and mold client satisfaction.
- As Vanguard's **Advisor's Alpha** research has suggested, for the typical advisor, the path to greater client satisfaction and asset growth should lead to an underappreciated destination—relationship management.
- A focus on relationship management takes time and commitment, and requires advisors to streamline some aspects of financial planning or wealth management and reallocate the time saved to the clients who increasingly demand and value it.
- Ultimately, clients determine the value of advice and, as our Advised Investor Insights™ research reveals, they clearly value and reward an advisor they highly trust with referrals and loyalty.
- To differentiate themselves from their competitors—both robo and human—advisors should embrace the fact that relationship management is not “customer service” but, rather, the crucial element of peerless financial advice.

Financial advice has undergone the same transformation, with technology liberating advisors to devote more time to advanced tasks. While the personal digital assistants of the recent past have been obsolesced by more effective and capable software to aid with client relationship management, the architect of the client relationship—the advisor—remains. And, while there is nothing physically dangerous about, say, manually rebalancing a portfolio, a technological surrogate to help with the task allows an advisor to allocate his or her time elsewhere. Again, that is a good thing.

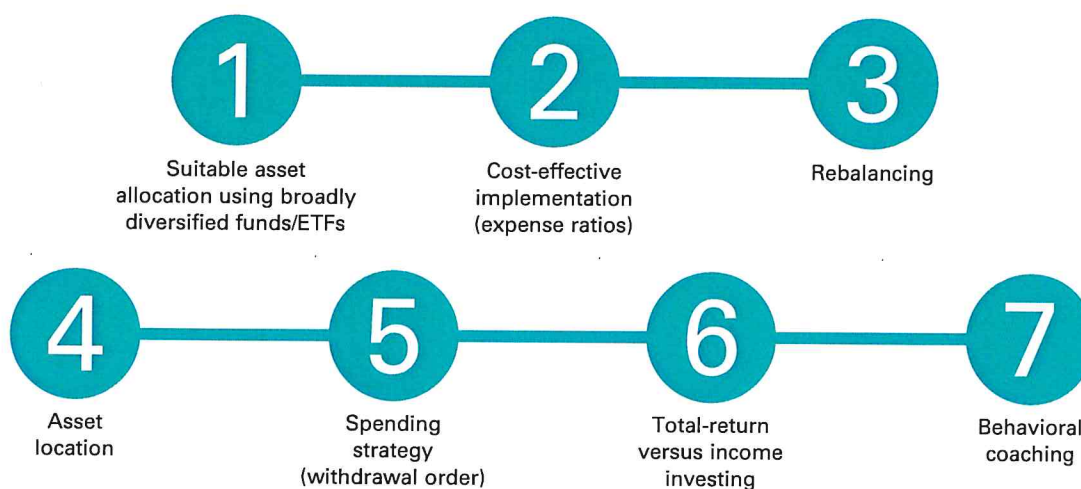
It is easy to view technology as a threat, but it does not have to be. It also does not mean advisors can ignore it and risk going the way of Blockbuster.² Advisors who embrace technology and adapt to the new environment can choose to be Netflix instead. Vanguard, through its **Advisor's Alpha** work, has been urging advisors for many years now to redefine their value proposition away from solely managing their clients' portfolios. That message is even more important today. Take a look at the figure below (Figure 4) from Vanguard's framework for quantifying the value of advice (Kinniry et al., 2016b). One could argue that six of the seven common opportunities to add value are now automated in some fashion, with the exception of behavioral coaching.

For many key decisions, people rely on past performance or expert testimonials to aid in decision-making. The past-performance heuristic may serve us well in many aspects of our lives—choosing a restaurant, car, or even a surgeon—but it is a generally unproductive way to choose investments. Changing this ingrained decision-making process and human behavior is difficult, but can provide a valuable opportunity to both educate the client and potentially improve the investment results for the client's portfolio. This is one reason we believe that human advisors and behavioral coaching will not be obsolesced by technology.

We are fairly certain that technology will not soon be building deep, trusting relationships, and this insight establishes the foundation for valuable behavioral coaching efforts with clients. We do not know for sure how it will happen or what particular software or company will drive the transition, but technology will reduce the time an advisor spends not just on routine administrative tasks but also on much of what advisors have traditionally defined their value propositions around. Whether it is embracing an existing robo advisor platform, firm-level software, or even a simple spreadsheet, expect technology to become more pervasive. The only thing we know with

Figure 4. A 'menu' of value-added services

Vanguard **Advisor's Alpha** strategy



Source: Francis M. Kinniry Jr., Colleen M. Jaconetti, Michael A. DiJoseph, Yan Zilbering, and Donald G. Bennyhoff, 2016. Putting a Value on Your Value: Quantifying Vanguard Advisor's Alpha. Valley Forge, Pa.: The Vanguard Group.

² Blockbuster was a chain of American-based home movie and video game rental stores that famously failed to adapt to the threat from video streaming on-demand services and was forced to file for bankruptcy in 2010.

Conclusion

Changes to the advice industry in the future are inevitable. The forces spurring these changes—regulations, fees, and technology—should benefit both advisors and their clients, rather than result in an Orwellian dystopia. Regulatory efforts to clearly define an advisor’s level of responsibility for a client’s best interests should increase investor confidence and perhaps encourage many more investors to seek advice. While attention to fee transparency and investment costs may result in fee compression, the efficiencies and benefits of cost compression and time management should allow firms to remain competitive and profitable. The trend toward technologically enabled advice is both friend and foe, bringing an increased opportunity for firms to profitably serve a larger number of clients and deliver Advisor’s Alpha even as it brings to the market potentially more competition for advised clients.

Ultimately, clients decide the value of advice and, as our Advised Investor Insights research reveals, they clearly value and reward an advisor they highly trust. To establish this level of trust takes time and a concerted effort from an advisor, and time is a limited resource. However, advisors have a number of tools and strategies to better use what time they have: They can use technology-enabled efficiencies to streamline client onboarding, portfolio construction, and ongoing management; form advisory teams to capitalize on the diverse skills and increased capacity to serve clients well; and use every contact with clients as an opportunity to make them feel valued, respected, and cared for. Advisors must judge for themselves the best use of their limited time, but the profits from allocating more time to their client relationships may be unsurpassed by other efforts.

As illustrated by our Advisor’s Alpha flywheel (Figure 14), the industry evolution that we’ve described in this paper creates a virtuous circle, benefiting both clients and advisors alike. With this outcome in mind, who could be so pessimistic as to believe that the future for the advice industry is not a bright one?

Figure 14. Vanguard Advisor’s Alpha flywheel



Source: Vanguard.

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P.O. Box 2600
Valley Forge, PA 19482-2600

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