Core Equity SMAs: Earn Appreciation from Your Clients

By Dennis Clark, CEO, Advisor Partners

Investment advisory firms occasionally sponsor a client appreciation event to express their gratitude, demonstrate an appreciation for their clients' trust, and reinforce the value of the relationship. It's also a good way to seek referrals or generate new assets from existing or potential high net worth (HNW) clients. Of course, during a bull market it is easy for everybody to "feel the love". Investors come to expect double-digit returns, and many give their advisor credit for picking the right stocks or fund that goes nowhere but up. But even then, professional investment advisors would never have expected an "Appreciation Day" for themselves.

So what would prompt your clients to throw a little appreciation party on your behalf? In the current market, two significant shifts are creating an opportunity for advisors: 1) A baby boomer wealth demographic has emerged in an age of increased investing awareness, and 2) financial services firms have adopted the Independent Advisor's "wealth manager" fee-only model to capitalize on that demographic. With this in mind, what can the professional investment advisor do that would exceed client expectations and compel their appreciation?

The Basics. Under the category of basics, there's the staple of relationship management: personal contact. It may as simple as "hand holding" for loyal clients, or crisis management to salvage those relationships that might otherwise leave. In either case, advisors should seek to prevent investors from making the most common investment mistakes: selling out near or at the bottom of the market cycle or holding concentrated positions in beaten down tech stocks hoping for a comeback. However, the more discerning baby boomer, as a consumer of financial services, has a higher standard. In contrast to simple reassurances and avoiding pitfalls, these clients better appreciate the value of basic investment advice when delivered with factual, content-rich explanations. In addition, they want solutions that focus on their particular situations.

Taking Action. To exceed client expectations in today's market, advisors should work toward controlling those elements which can be controlled with an emphasis on individual customization and comprehensive tax management. In this regard, what may seem like intangible concepts to the investor actually bring about tangible benefits to the investor's wealth plan. Advisors provide value by explaining these concepts and exceed expectations by executing on them. As an example, clients holding large unrealized gains will particularly appreciate a plan to retain those existing positions while at the same time diversifying their equity exposure. Or a plan to use losses from recent market volatility to offset gains that might be incurred in reducing concentrated positions or to offset gains outside the portfolio. [Ed Note: See our related article on diversifying concentrated low basis positions.]

Coordinate for Value Added. Engage the client's other financial professionals, such as an attorney or CPA, in proposing a more comprehensive approach to solving the client's wealth management issues. Take on the role of leading the team towards the goal of designing and implementing a client-specific solution—the mainstay of the new wealth management paradigm. The professional team will appreciate the plan's inclusion of a long-term strategy for managing risk through diversification, while minimizing turnover and expenses, as well as managing taxes. Having grown up in an age where Madison Avenue spent millions of dollars convincing baby boomers that they were the center of the commercial universe, the client will appreciate your proactive, customized approach because, after all, "It *is* all about *me.*"

Specific Solutions. Providing an actively tax managed, diversified, custom equity portfolio is easier than you might think. Today, advisory best practices include investment vehicles that feature lower costs and allow a measure of control over tax liability. And while several of these vehicles take a structured approach to the domestic equity allocation—index funds, exchange traded funds (ETFs), and separately managed accounts (SMAs)—it is the separate account that most comprehensively allows the advisor to accomplish these objectives. SMAs come in a variety of forms, but the focus here is on a single separate account for the core equity allocation. Comprised of individual securities, it is tailored to the individual, representative of the entire US equities market, and actively tax managed. This account, in particular, effectively minimizes the drag on gross performance caused from unintended capital gains taxes, portfolio turnover, commissions and operating expenses. For larger client relationships, consider adopting a single SMA to replace mutual funds as the core equity anchor of an investment portfolio. In addition to more easily accommodating tax loss harvesting, it allows the advisor:

- Manage the client's tax liability at inception and ongoing thereafter.
- Broadly diversify the core equity exposure.
- Accommodate existing positions.
- Customize the client's specific exposures to equity styles, sectors, industries, social screens or even individual companies.
- Easily incorporate multiple asset styles and classes without the administrative burden of using multiple SMAs, index funds or ETFs.

A single separate account as the core equity product is in complete harmony with the financial advisor's value proposition. This approach allows more customization, personalization and control than funds, ETFs or multi-manager accounts, including the newer Multiple Style Portfolios (MSPs) or Multiple Discipline Product (MDP). It's especially appropriate for advisors who believe in market efficiency, and it's consistent with the philosophy of "controlling the controllable". In particular, controlling costs—including bundled product costs and taxes. The single separate account in a "core and explore" context positions the advisor to delight their clients and distinguishes them from that portion of the competition merely "selling product".

Keep It Simple. Implementing an overly complex, expensive product offering can be distracting enough to denigrate the level of service and personal attention your clients expect. Instead, consider the "core and explore" approach of combining a single, core separate account, managed to an active tax mandate, with explore components (such as mutual funds, actively managed separate accounts or hedge funds) that pursue alpha unconstrained by tax considerations or investor restrictions. This retains much of the operational ease of mutual funds, since the core SMA—representing the bulk of the US domestic market—does most of the "heavy lifting". It also maximizes net return through active tax management, investor customization and low cost. The core equity account avoids the administrative burden of multiple separate account managers assigned to multiple asset classes, and the overhead of MSP/MDP accounts (i.e., there are no "overlay managers" checking for "wash sales" between portfolios or due diligence units auditing the style adherence among managers.).

Independent Advisors are Appreciated. As a group, financial advisors continue to increase market share, in part because investors value the advisor's role and freedom from conflicts of interest. Investors want to feel comfortable about using an advisor to simplify what is otherwise a complicated process. However, many investors are unaware of the myriad choices and methodologies available to their advisor. Since few investors systematically compare one advisor to another, they lack the basis to evaluate the advisory experience. It's kind of like the practice of military dentistry during WWII: Instead of working around the "existing positions" by filling or capping teeth, the GI's teeth were often simply pulled and replaced with dentures. At a surface level, you can't argue with the result, a full mouth of teeth. But armed with a complete knowledge of best practices, the "clients" could certainly demand a result with better long term prospects.

Investor appreciation of the advisor's value deepens once they realize that, like the GI's who stopped going to Army dentists, not all advisory practices are the same. Until they experience a cataclysmic event, like having a few teeth pulled or paying a hefty tax bill (same difference), most clients may not fully appreciate the benefit of an investment advisor's diligent, detailed and thoughtful efforts. Such an event can be a moment of truth in the client/advisor relationship. Armed with the latest in best practices, advisors can prevent that event from becoming a loss, and instead turn it into an opportunity.

Best Practices for All Seasons. Investing clients in today's volatile market is an ideal time to adopt the latest in best practices. Active, ongoing, tax management within a single core equity separate account is the most efficient means to maximize after-tax return. By harvesting net losses and using them to offset realized gains or to stockpile them to offset future tax liability, clients improve their benchmark fit and at the same time garner tangible dollar-cost benefits that can easily dwarf the fees they pay you, the advisor. Once advisors raise the bar to exceed expectations by using this approach, client approval increases proportionately. Compared to the basics of risk reduction and diversification, clients find the benefits of personalization and customization much more tangible. So who knows, maybe you'll get that appreciation day after all.

Advisor Partners, LLC, is a separate account manager that specializes in working closely with financial advisors to construct and manage highly customized and actively tax-managed core equity portfolios for high net worth investors.