

# INVESTMENTS & WEALTH MONITOR

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## A Model Approach for Evolving Times

*By WisdomTree Advisor Innovation Team*



**INVESTMENTS & WEALTH INSTITUTE<sup>®</sup>**

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**I**nvestors want more from their advisors—quality investments, tailored advice, and personal service—and they want it now. But as their demands grow, so too does competition and the number of regulations advisors must meet.

Third-party models can help advisors deliver what investors want and need. More models are available today than ever—from home offices, asset managers, strategists, and other resources. However, even with this wide selection of available options, few advisors are leveraging these models.

We were determined to discover why. Our industry standard-setting research spans financial advisors and—most importantly—investors. We spoke to both groups before and after the March 2020 volatility. We found that advisors have misconceptions about third-party models and the advantages they can offer, and that they also have misconceptions about what their clients value and how their clients view models.

## ADVISORS' MISPERCEPTIONS ABOUT MODELS AND HOW CLIENTS SEE THEM

Our research found that many advisors associate investment management with their core value proposition. These advisors either do not believe in outsourcing this role or do not want to outsource out of concern that it may damage their advisor-client relationships. Their perception is that they are expected to make all the decisions about investments and also build portfolios tailored for their clients. The perception is that

third-party models do not allow for either possibility. Consider the following:

- 54 percent of financial advisors believe third-party model portfolios do not allow tailoring to client situations.
- 56 percent of advisors believe that third-party models do not allow them to deliver personal service.
- 50 percent of advisors believe it's difficult to differentiate themselves if they use models.
- 34 percent of advisors are reluctant to make the change from an existing portfolio to a new model because they want to avoid capital gains.

We discovered, however, that these assumptions are unfounded on two levels: (1) investor perceptions and (2) model applications and approaches.

## CLIENTS VALUE THEIR ADVISORS

When we spoke to investors, more than 90 percent said they see their advisors as a critical part of their financial success. In fact, when we asked about the benefits of working with an advisor, both pre- and post-volatility, clients identified financial expertise and advice as the number-one benefit. Confidence that advisors are working in their best interests and staying up to date with the markets round out the top three benefits.

Clients clearly view their advisors as the experts in the relationship and expect them to leverage technology, resources, and third-party expertise to provide them with the best investment options. They expect financial advisors to conduct extensive research into investments and access more technical and in-depth

information than investors themselves can access through Google. Consider the following changes we found before and after the March 2020 volatility:

- The number of investors who said they value the high-quality financial services advisors provide increased by 51 percent.
- The importance investors placed on customized services decreased by 6 percent.
- The number of investors who said they felt it was important for an advisor to help them understand investment and strategy recommendations increased by 10 percent.

## INVESTORS WELCOME THIRD-PARTY MODELS

Although some investors are unaware of model use, nearly half of those who responded said they believe their financial advisors already may be using model portfolios. The majority of investors surveyed said they are open to third-party models. In fact, following the March 2020 volatility, nearly 90 percent of investors surveyed said they welcome model usage in their portfolios—and that includes 83 percent of the boomer investors surveyed.

**Investors said they believe third-party models provide additional expertise that will help their portfolios.** Our research concluded that investors find comfort in knowing that third-party models provide the benefit of an asset management firm's analysts', strategists', and PhDs' collective expertise. From the investors' perspective, advisors using models are combining

valuable research and data with intimate knowledge of clients' needs. So, clients actually view applied third-party models as tailored responses to their unique situations and goals. Consider the following:

- 63 percent of investors surveyed pre-volatility said they believe that using models will have a positive impact on their overall portfolios.
  - › This is true among all generations, with boomers at 44 percent, Generation Xers at 59 percent, and millennials at 78 percent.
  - › Post-volatility, the overall number increased to 70 percent.
- More than half of investors (63 percent, including 64 percent of boomers) surveyed pre-volatility said they believe that financial advisors using third-party models are providing a more sophisticated asset allocation approach backed by the extensive

research and technology of an asset manager's team.

- › Post-volatility, the number of investors who said they felt it was important for an advisor to use technology to enhance investment decisions increased by 5 percent.
- 63 percent of clients with advisors—and 59 percent of those without advisors—said they strongly agree with the following statement: “A financial advisor using a preset investment model portfolio provided by either their firm or a third-party source is comparable to a doctor that has access to artificial intelligence (AI) networks that contain millions of medical records and case studies to assist in diagnosis or successful treatment outcomes.”

**Clients believe models could give advisors more time to focus on clients.** Many clients said they expect that advisors who

incorporate third-party models into their practices would have more time to focus on them and their portfolios (see figure 1). In fact, 40 percent of investors surveyed said they believe the use of third-party models would provide you with more time for them (this includes 45 percent of millennials, 38 percent of Generation X, and 33 percent of boomers surveyed). These respondents agreed with the following statements:

- My financial advisor would have more time for research and gaining helpful knowledge such as understanding current market trends and future impacts.
- My financial advisor would have more time to talk with me about my goals or answer questions.

**Investors are more likely to choose an advisor using models.** A more pressing need given today's market volatility is the retention and acquisition of clients. Interestingly, we found that investors said they were more likely to switch advisors if they were aware that another advisor was using third-party models (see figure 2). More than half of clients surveyed (58 percent) said they would consider switching advisors if the new advisor properly promoted a models-based practice. This is not limited to one generation:

- 84 percent of millennials said they would consider switching advisors if the new advisor was using third-party models.
- 76 percent of boomers said they would consider switching advisors if the new advisor used third-party models.
- Only 10 percent of those surveyed, however, said they would consider making a change if their current advisors were already using models.

**ADVISORS ALREADY USE AND APPRECIATE MODELS**

Many advisors have built their own models. However, our research shows the majority of these models may be ready for updating (see figure 3). In fact,

Figure 1

**HOW CLIENTS EXPECT ADVISORS SPEND THEIR TIME**

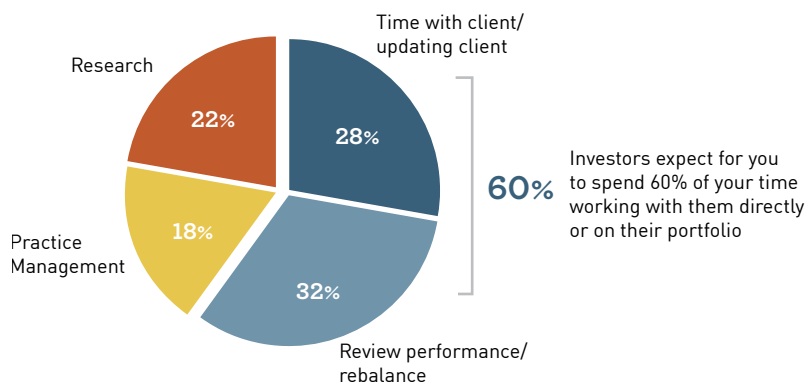


Figure 2

**THIRD-PARTY MODELS MAY HELP ADVISORS ATTRACT AND RETAIN INVESTORS**



3.8 out of 10

At any given time, 38% of your clients are thinking about shopping for a new advisor



5.8 out of 10

The percentage increases to 58% that would consider switching advisors if the new advisor properly promoted a third-party models-based practice (84% of millennials)

75 percent of self-built models were developed between five and 15 years ago (53 percent were built more than 10 years ago). We also found that 63 percent of advisors who developed their own models see value in third-party models, and had they been available at the time, 82 percent of those surveyed said they would have opted for using third-party models instead of building their own.

**Advisors agree that third-party models provide benefits to their clients.** Even though many advisors use their own models, our research showed that the majority of them understand—and appreciate—the advantages third-party models can provide to their clients. Consider the following:

- 94 percent of advisors surveyed said they believe third-party models enable them to apply institutional quality research and analysis to clients’ portfolios.
- 90 percent said they believe third-party models provide an efficient way to share investment strategies with clients.
- 90 percent said they believe third-party models will help them create a consistent client experience.
- 90 percent said they believe third-party models help them leverage the knowledge and expertise of others.

**Advisors agree that third-party models provide benefits to their practices.** Additionally, our research found that the majority of advisors believe third-party models can help with many areas of their businesses including scaling and growing their practices. For instance, 92 percent of advisors surveyed said they believe models could help improve the efficiency of their practices, 88 percent said they believe models will help improve the services they provide to clients, and 89 percent said they believe models will enable them to scale their businesses easily. Additionally, advisors seem to believe third-party

models can help them meet changing regulations and compete amid ongoing fee compression. Consider the following:

- 90 percent of advisors surveyed said they believe models provide a defined process that will help with increasing regulatory scrutiny.
- 66 percent of advisors surveyed said they believe their practices could better handle fee compression if they implement third-party models.
- 63 percent of advisors surveyed said they believe third-party exchange-traded fund (ETF) models, more specifically, could help with fee compression.
- 73 percent of advisors surveyed said they believe that the implementation of third-party models would help their practices comply with Regulation Best Interest.<sup>1</sup>

**HELP ADVISORS DELIVER WHAT CLIENTS NEED**

As you may know, Maslow’s hierarchy of needs serves as a basis for understanding human motivations.<sup>2</sup> We have found that it also can be adapted to create an “advisor value pyramid” of investor needs, as shown in figure 4. The pyramid describes the products and services you offer that investors value at each level of the pyramid.

In essence, investors want advisors to deliver it all. They want your expertise and your time because they look to you to deliver emotional and life-changing products and services that no one else can. As you might expect, when we compared these same findings pre- and post-volatility, we found that post-volatility investors had a much stronger need for the life-changing value of

**THIRD-PARTY MODELS CAN WHEN ADVISORS FIRST DEVELOPED THEIR OWN MODELS**

Figure 3

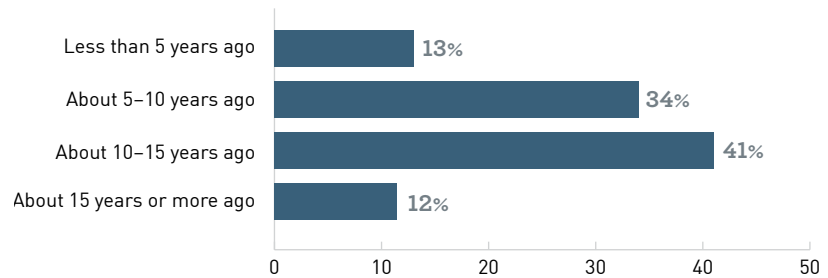


Figure 4

**ADVISOR VALUE PYRAMID**



“Keeps me motivated so that I will reach my financial goal.”

Consider that once the functional needs at the bottom of the pyramid are met, the higher needs emerge. In Maslow’s hierarchy, the functional needs are food and shelter. For investors, the functional needs are related specifically to their portfolios. Once these needs are met, investors look to advisors to help meet their emotional and life-changing needs.

Leveraging third-party model portfolios and the vast expertise of model portfolio providers can help advisors meet clients’ functional needs, providing them with additional time to deliver the emotional and life-changing services that clients value most.

### THIRD-PARTY MODELS PROVIDE CUSTOMIZATION, CONTROL, AND MORE

We found that many advisors who use or would use third-party models customize their portfolios and leverage different models for different clients. In fact, although 54 percent of advisors claimed the perceived lack of customization around third-party models was a reason to avoid them, we found that the majority of advisors who use third-party models (56 percent) do customize them. And 74 percent of advisors are likely to use different model providers for different accounts within a client’s portfolio.

We also found that 76 percent of the advisors who participated and were concerned about capital gains said they believed that a tax-advantaged strategy model, such as one leveraging ETFs, would be very or extremely likely to minimize this concern. In fact,

third-party ETF models can enable tax-loss harvesting, which, according to Morningstar, is a powerful tool that can help enhance returns.<sup>3</sup>

### ADVISORS EXPECT THEIR MODEL USE TO GROW

Our study found that most advisors said they expect model use to grow in general, and they said they specifically anticipate their own use to grow. Consider the following:

- 92 percent of advisors said they agree or strongly agree that model use will continue to grow in the future.
- 58 percent said they expect their own model use to grow in the future.

### WHICH INVESTORS ARE MOST OPEN TO MODELS?

Our research also looked at psychographic segmentation to understand which investors are most open to model use. We found a few different segments. The segments most open to models are those we call the Open segment. In fact, 80 percent of the Open segment embraces models, compared with 53 percent and 51 percent of the Backseat and Resistant segments, respectively.

The Open segment represents the most loyal clients and those who are most open to risk. They are likely in their early-to-mid 40s, have household income of more than \$207,000 per year, and have more than \$665,000 in investable assets. They are early adopters, are viewed as a valued resource to others, and often recommend products and services to friends and family. In our survey, a greater percentage of Open-segment responders said the following financial goals and values were “extremely

important” (compared with a much lesser percentage of all respondents):

- Wealth preservation—61 percent (vs. 33 percent of all respondents)
- Wealth management—59 percent (vs. 28 percent)
- Accumulation—52 percent (vs. 25 percent)
- Education—49 percent (vs. 20 percent)
- Risk management—49 percent (vs. 20 percent)
- Wealth transfer—48 percent (vs. 21 percent)
- Liquidity—44 percent (17 vs. percent)

The Backseat segment, however, still may be worth pursuing. In fact, the Backseat segment appears to value some of the advantages of models in greater numbers than those in other segments (see table 1).

The Backseat segment represents clients in their late 50s to early 60s who already may be retired. This segment prefers to let advisors take the lead; they tend to put more importance than other investors do on the advantages they believe advisors provide such as financial expertise and advice, keeping up with the markets, and looking out for clients’ best interests. Backseat-segment investors tend to be more conservative than Open-segment investors, but with an average of nearly \$775,000 in investable assets, they do have a little more to lose.

### COMMUNICATION IS CRITICAL

Advisors generally understand the importance of communicating with their clients. But when it comes to third-party models, they are often at a loss for how to get started. Our research found that 82 percent of investors prefer to get their financial advice through human interactions, so the first step may be to speak to clients live—whether in person, over video conferencing, or on the phone.

#### *The language of models*

When it comes to presenting the concepts, we conducted research on the language investors prefer. We asked

Table 1

### ADVANTAGES OF MODELS

Stated Benefits From Model Use in My Portfolio (very important / important)	Open segment	Backseat segment	Resistant segment
Applies a current/updated approach to investing	42%	44%	34%
Incorporates a full asset manager team’s research to my portfolio that is facilitated through the advisor	40%	54%	42%

investors to review the following model concept statement:

*Technology is rapidly changing our world, creating a shift to Uber from taxis, online streaming from DVDs, 24/7 connectivity from 8 to 5. Financial services have also experienced a technology shift. Gone are the days of an advisor picking a stock, or even a mutual fund. Today, advisors have access to a multitude of investment model portfolios created by teams of research professionals focused only on the markets and their products. Now, advisors can focus more time on their clients and leverage this advanced technology to support them.*

We found that the majority of clients liked this concept, and many said it helped them to understand third-party model portfolios. In fact, 65 percent said it was somewhat, very, or extremely different than the way they had previously understood models. With this positioning, 63 percent of investors said they believed third-party models would have a positive impact on their portfolios.

Additionally, when we tested the concept below, we found that investors said they believe in the advantages of leveraged expertise:

*A financial advisor using a preset investment model portfolio provided by either their firm or a third-party source is comparable to a doctor that has access to artificial intelligence (AI) networks that contain millions of medical records and case studies to assist in diagnosis or successful treatment outcomes.*

In fact, 63 percent of investors surveyed said they equate an advisor understanding their financial needs and applying a model to a doctor conducting an assessment of their health—so this analogy also can be useful when presenting third-party models to clients.

## RESEARCH DETAILS

WisdomTree's Models Research Initiative maintained a  $\pm 2.3$ -percent margin of error among consumer investors across generations and a  $\pm 6.2$ -percent error rate among financial advisors. A mixed methodology was applied that included a robust base

of more than 2,000 constituents in the models' value chain, as well as in-depth interviews and online panel-based conversations that were conducted on the topic. Interviews were conducted October 16–November 19, 2019, and May 1–July 21, 2020.

### COMMUNICATION BEST PRACTICES

In the course of conducting our research, we held a number of advisor panel sessions to uncover best practices among leading advisors. When it came to communication, these were the tips that most of the participants agreed upon:

#### Quality (and relevance) over quantity.

Advisors want to engage clients and prospects in conversations, but they should not publish content merely for the sake of publishing content. Advisors should instead create a well-thought-out plan, with a frequency that advisors are comfortable with, and one in which they can stay true to the mission of providing only meaningful content.

**Put yourself in their shoes.** The world of finance can be daunting for many investors—whether due to the overwhelming confusion around the growing number of investment options, the rising costs of retirement, or the difficult (even if temporary) climate facing many people today. Advisors who can demonstrate an understanding of clients' specific circumstances can establish themselves as trusted resources and a welcomed bridge between where they are today and where they want to be tomorrow.

**Show, don't tell.** Remember that investors see advisors as the experts, but be mindful to avoid using an arrogant tone or industry jargon. The expert voice—and graphics—should be friendly, approachable, relatable, and smart all at the same time. Illustrations that convey the concepts in simple, direct ways are perceived as much smarter

than complicated renderings that require an advanced degree to decipher.

**Inform, don't sell.** Providing clients and prospects with useful content that helps them become better-informed investors can be a smart way to build a mutually beneficial relationship. By regularly giving clients useful, relevant content, advisors establish a level of trust, and when they or their friends need financial advice, the advisor will be top of mind.

### CONCLUSION—THIRD-PARTY MODELS PROVIDE FIRST-RATE BENEFITS

Clients today expect a lot from advisors. They expect advisors to provide the following:

- Be the expert in the relationship who leverages technology, resources, and third-party expertise to provide the best investment options
- Understand their situations and provide a comprehensive range of services and solutions that can help them meet all their financial and wealth goals
- Help them meet their functional needs as well as their emotional and life-changing ones

Clients also expect advisors to do this in an unprecedented environment of increasing regulations, competition, and extensive fee compression. Additionally, we found that nearly 40 percent of advisors are looking to significantly grow their client base through business development over the next five years.

We believe third-party models can help advisors meet all their clients' expectations, enable them to achieve the growth they desire, and meet ever-evolving regulatory requirements and other industry challenges.

Your value to your clients encompasses many facets. Adopting third-party models can add to your value by enabling you to focus efforts on the emotional and life-changing needs that your clients value most. This may require you to modernize your value proposition from one that focuses only on functional requirements, such as asset allocation, to one that rises to a higher level. It's important to remember that this shift is an "and" approach rather than an "instead of" approach. Your true value lies in providing excellence in both areas—functional and higher emotional level needs.

Consider that, as the person who knows your clients best, your strength lies in identifying the partners and strategies that best align with their goals and values—and can help them meet their financial and emotional goals. So step back, take a breath, and leverage the expertise of third-party models. That is how you can become a modern advisor. ●

*The WisdomTree Advisor Innovation team is dedicated to collaborating with and providing financial advisors with relevant tools, solutions, and opportunities to grow their business or improve relationships with clients. Contact the authors at [info@wisdomtree.com](mailto:info@wisdomtree.com).*

## ENDNOTES

1. See Regulation Best Interest: The Broker-Dealer Standard of Conduct," <https://www.sec.gov/rules/final/2019/34-86031.pdf>.
2. Maslow's hierarchy of needs is a motivational theory in psychology comprising a five-tier model of human needs, often depicted as hierarchical levels within a pyramid.
3. "An Empirical Evaluation of Tax-Loss Harvesting Alpha," Morningstar (2019), <https://www.cfainstitute.org/en/research/financial-analysts-journal/2020/0015198X-2020-1760064>.

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