KEY AREAS OF FOCUS FOR WEALTH MANAGEMENT FIRMS IN 2019

Mercer has detailed five key areas of consideration as wealth management firms help themselves and their clients navigate the current industry landscape.

PREPARING YOUR PORTFOLIO FOR LOW RETURNS

Expected lower growth, high valuations and compressed spreads have made traditional assets less attractive. Additionally, investment management fees across both active traditional and alternative strategies have fallen. In this context, investors should be considering opportunities to increase asset class diversification and manage their risk within traditional equity and fixed income markets by:

- Reviewing rebalancing policies to ensure clients are taking profits and reinvesting opportunistically
- Considering more active strategies to avoid "crowded" trades and identifying non-benchmark opportunities
- Evaluating alternative investments that can provide opportunities for portfolios to benefit in various market environments
- Examining and preparing fixed-income portfolios to navigate through the late credit cycle
- Revisiting and stress-testing the strategic asset allocation to ensure it is fit for purpose and robust enough to withstand the shocks that potential headwinds may present

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SIMPLIFYING AND DIVERSIFYING

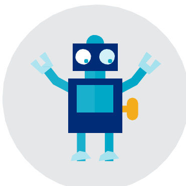
Increasing the use of active management and alternatives does not, on its own, reduce risk — it simply shifts it from one of "beta" to "alpha." Just as we advise that clients diversify the beta exposures in their portfolios, it's important to not put too much emphasis on any single manager's skill. For this reason, we believe that multi-manager portfolios that can combine best-in-class managers within an asset class are optimal for many investors.

- While diversified hedge fund portfolios fell out of favor in recent years, as investors sought to build them themselves, fees for pre-built offerings have come down and some investors are considering moving back into diversified portfolios.
  - Advisors should take a look again at high-quality, commingled hedge fund programs for their clients who have smaller asset pools to allocate and/or who are insufficiently diversified today.
- While seeking more differentiated active managers, firms face challenges, from explaining underperforming small manager positions to implementation issues when searching for substitutes after talented managers close to new assets.
  - Multi-manager portfolios can help firms overcome these challenges — firms can consider building custom strategies or evaluate third-party diversified portfolios.

INTEGRATING ESG — IT'S NOT JUST ABOUT DOING "GOOD"

Investing without consideration for the way the world is changing demographically, socially, environmentally, technologically and politically is increasingly, and rightly, under question. Governments, investors and consumers are increasingly demanding a long-term and rounded perspective from those with responsibility to manage capital. Academic literature, in general, continues to confirm our belief that the consideration of environmental, social and governance (ESG) factors at the company level can lead to outperformance, especially over the longer term. ESG integration into investment decision-making and portfolios requires manager skill, a clearly defined investment style and consideration of appropriate time periods to achieve desired outcomes — as would be the case with any mainstream investment strategy.

- Investors should consider these trends to identify asset classes and strategies that can profit from social and regulatory pressures while considering holdings that are most at risk, focusing on appointing managers who have strong ESG credentials.
- Alongside the support for sustainable return perspectives, advisors should consider nontraditional risks to portfolios such as climate change risks.



LEVERAGING TECHNOLOGY FOR CLIENT OUTCOMES AND EFFICIENCY

Firms need to continue to adapt to the ever-changing technology landscape in order to remain competitive. The “robo” movement has shown firms that the tools created to support it (that is, rebalancing software and aggregation/analytic tools) are increasingly available to traditional advisors. Similar to how insurance companies are using data from fitness trackers to more accurately assess risk, financial firms can aggregate data and actions across their client bases to provide more targeted investment direction for others. Technology has provided advisors with client-tailored portfolio recommendations in an effort to improve client outcomes, including the ability to more easily access and allocate to alternative investments. This has enabled advisors to spend more time serving their clients and/or developing new business while helping firms scale their platforms.

- As these capabilities become more robust, advisors need to learn how to incorporate them into their own practices; however, firms need to ensure that they are evaluating the risks that come with reliance on technology.
- As consumer data protection has become a higher focus, as evidenced by the European Union’s General Data Protection Regulation (May 2018), advisory firms should ensure that their cybersecurity procedures are in line with best practices.

OPTIMIZING YOUR GOVERNANCE STRUCTURE FOR CLIENT OUTCOMES AND REGULATORY REVIEW

With continued consolidation in the wealth management industry, many firms find themselves overseeing significantly more assets today than they did just a few years ago. While an increased level of assets under management provides great opportunity for scale, it also increases the risk of missteps. Firms should consider whether their governance structure in place today strikes the right balance of flexibility, consistency and risk management.

- The proposed SEC Fiduciary Standard seeks to limit potential conflicts of interest and increase transparency; having a documented process for investment evaluation, implementation and ongoing monitoring may be the key in showing regulators and clients that firms are meeting this standard whether in an advisory or brokerage capacity.
- While assets under management continue to rise, firms’ margins are still under pressure; engaging outside specialists can help bolster the governance process by shifting primary responsibility for middle- and back-office functions to third parties and allow firms to leverage the governance process of other established players. By articulating a strong set of investment beliefs and processes, advisory firms can better differentiate themselves from their peers.

ABOUT US

Mercer's Wealth Manager Solutions practice is dedicated to advancing investment management capabilities of financial advisory firms. Mercer leverages its global infrastructure, which has been fortified from providing advice to large institutional clients for over four decades, to provide innovative strategies for firms serving individual investors. Our expertise in delegated solutions, manager research, alternative investments and portfolio construction allows the flexibility for a customized approach.

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Important Notice

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