In-Discretionary Accounts

By Kerry Pechter *Thu, Jun 11, 2015*

Investment performance of popular "Rep-as-Portfolio-Manager" accounts lags direct-sold packaged portfolios, say analysts at Cerulli Associates and Fuse-Research.

After the financial crisis, when many of their clients lost money, some fee-based financial advisers switched to a "rep-as-portfolio-manager" style of managed accounts, which gave reps discretion to trade for clients.

In theory, the change would enable them to respond more nimbly to volatility, or be less prone than clients to panic selling.

But two industry analysts now say that the switch to so-called RPM has yielded lower returns for clients, as well as unnecessary trading and higher profits for advisers, relative to managed accounts designed by broker-dealer home offices.

"It's bad for investors," said L. Neil Bothan of Fuse Research. "Coming out of 2008, clients were upset that no one intervened to cut their losses, so advisers, who had presented themselves as investment experts, were feeling pressure. Investing was supposed to be their value-add."

Reps turned out to be better at sales than at tactical management, however—even when they worked in teams and one focus full-time to the portfolio. "I don't believe that advisers are experts at investment management," Bothan told *RIJ*. "They should leave it to the home office. In making tactical moves, they end up susceptible to the same emotional swings as the client. And with the current technology, the velocity of churn is amazing. They just push a button and a portfolio change goes through all their accounts."

A new report from Cerulli Associates finds that direct-sold managed accounts, where the portfolios are centrally managed, have outperformed advisor-driven discretionary portfolios over the past five years, because the managers of packaged portfolios are more likely to stay invested through downturns and recoveries.

In *Managed Accounts 2015: Battle for Discretion*, the 13th in a series of annual reports on the topic, the Boston-based research firm analyzes the market for fee-based packaged portfolios. The report uses surveys of asset managers, broker/dealers, and third-party vendors and covers most of the $900 billion in managed account assets.

"Hybrid programs underperformed packaged programs by 2.96 percentage points over the five-year period and advisor-driven programs underperformed by 3.15 percentage points. While three percentage points over five years may not seem substantial, if the outperformance is projected onto the AUM of an advisor's entire practice, it can amount to hundreds of thousands of dollars of "lost" production revenues," Cerulli's new report said.

Cerulli has been tracking the flow of money into direct-sold managed portfolios. "Much of the success of packaged portfolios has been driven by a new business model, with direct platforms gathering significant assets without having a traditional advisor force," said Frederick Pickering, research analyst at Cerulli, in a release.

Advisors [who use packaged portfolios] spend only about one-sixth of their time on investment management, and they are more swayed toward changing funds by "qualitative factors such as a fund company's reputation or wholesaler relationships," Cerulli noted. "Home office teams are more quantitative in their approach to [fund] manager selection."

"We believe the outperformance is primarily driven by qualified home-office teams dedicating their time to asset allocation, manager selection, and staying invested in the market during downturns," Cerulli said. "Advisors have a lot of hats to wear, and while advisors value flexibility, they must remember that portfolio construction is not a part-time job. On average, advisors spend 60% of their time on client-facing activities, 18% on administrative activities, and only 17% on investment management."

According to the report, it's widely agreed that fee-based advisors have gravitated to rep-as-portfolio manager platforms for greater flexibility and control. But more than half of the asset managers—who sell funds and ETFs to the managed account market—in the Cerulli survey said that they believe advisors are using RPM because it is more profitable for the advisor rather than good for the client.

"None of the asset managers surveyed believe that advisors are passing cost savings on to clients. It would appear, therefore, that advisors may be choosing to use RPM not only for the flexibility that it gives them but also for the economic benefits that accrue to the advisor," the report said.