

Almost There

Results from the Top Wealth Managers Quarterly PULSE Survey

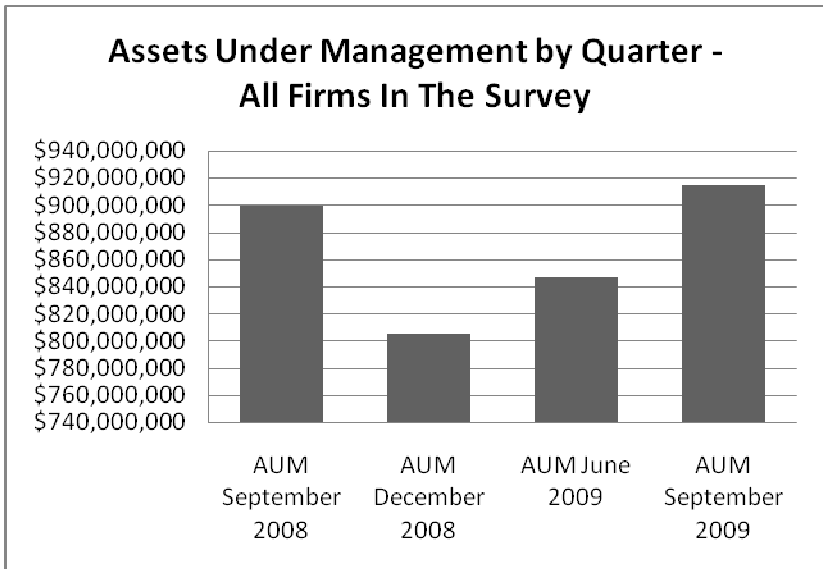
Third Quarter 2009

By Philip Palaveev

Building a wealth management business can sometimes make a wealth manager feel like Sisyphus, the mythological character punished by the Greek gods to endlessly push a rock up a steep mountain, only to see it roll down when he is almost at the top. The same thing happened to many owners of wealth management firms—they had labored for years taking the business to the top, only to see it tumble down in the last 12 months. Then again, it could be worse—we could be pushing someone else’s rock up the mountain. At least this is our rock; we own it and we will get to the top in spite of the gods. In the third quarter of 2009 we caught the rock at the bottom of the mountain and started our slow journey back up the mountain.

One hundred and two wealth management firms qualified to participate in the first edition of the Top Wealth Managers Quarterly PULSE survey, providing us with up-to-date statistics on their growth, staffing and management decisions. The survey gives us real-time insight as wealth

managers approach the critical budgeting projections and planning for 2010.



On average, firms in the survey started the year with \$805 million in assets under management (AUM). At the end of September 2009, they had grown their assets to \$915 million--a growth rate of 8.0%. The growth came primarily as a result of market performance and existing clients’ return to the market.

In the third quarter of 2009, firms grew their assets from \$847 million at the end of June to \$915 million at the end of September. This growth rate of 13.7% was the strongest the industry has experienced since the beginning of the crisis. On average, the firms in the study have grown their AUM by 1.7% since the end of September 2008. The process of recovery has started but as we will see, it is slow and is met with resistance.

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New Client Acquisition is Slow

The very fact that firms are back to where they were at the end of September 2008 is remarkable—when we covered the results of the Top Wealth Managers annual survey, we saw an 18% decline in AUM and gap that appeared very deep. The strength of the market in the second and third quarter, however, helped firms regain their losses and it appears that most firms will record 2009 as a growth year in terms of AUM. The asset levels of June 2008 are still some distance away, but the process of growth has restarted.

Remarkable Growth in AUM	Average	As %
June 2009 AUM	\$846,825,133	100.0%
Plus: New Clients	\$17,604,184	2.1%
Plus: New Contributions from Existing Clients	\$22,538,089	2.7%
Plus: Market Performance	\$57,532,200	6.8%
Less: Market Performance	-\$0	0.0%
Less: Withdrawals	-\$22,298,180	-2.6%
Less: Lost Clients	-\$7,294,273	-0.9%
Ending AUM	\$857,017,303	108.0%

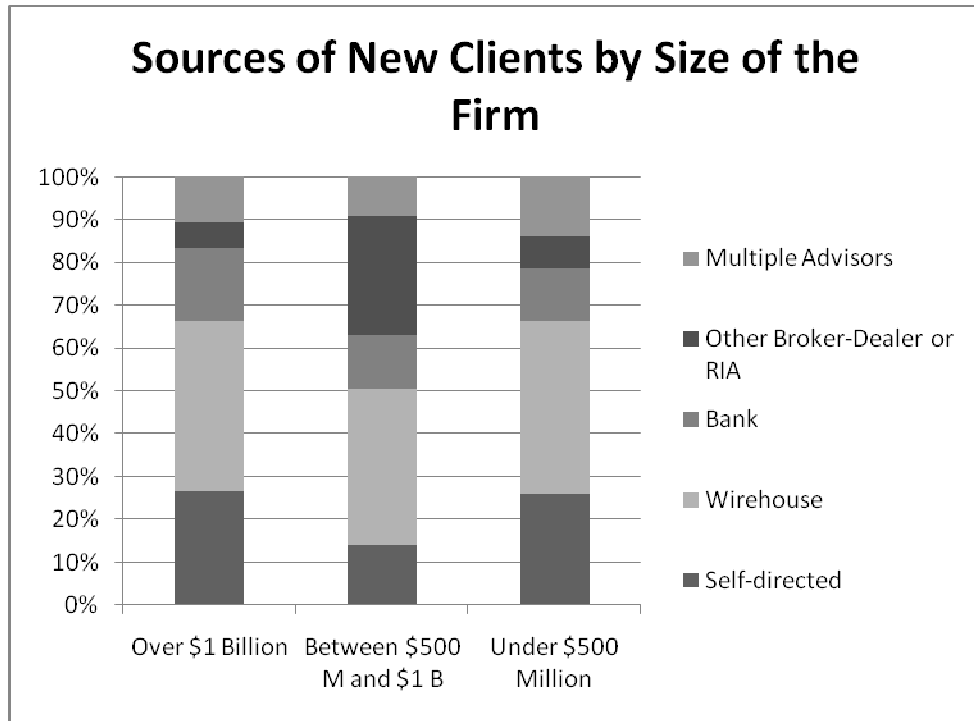
On average, firms in the survey gained 6.8% growth from market performance. Existing clients also contributed a substantial amount of assets, returning to the market. The contributions were equal to 2.7% of the AUM. They were almost matched by the withdrawals, though, as clients drew 2.6% from their accounts.

The critical number in the table above is new assets from new clients—this is the true measure of a firm's ability to grow again. In the third quarter, firms had 2.1% growth through new clients. Unfortunately, when 2% walked in through the front door, 1% walked out through the back door—as assets withdrawn from lost clients were 0.9%. As a result, the net business development growth number for the quarter was 1.2%, or an annualized rate of 4.8%—almost one-third of the pre-crisis levels.

For the sake of perspective, in our experience, an average firm's growth from new clients in 2007 was around 12%, and the typical loss of clients was less than 1%. What we are seeing right now is still a slow rate of growth in new clients and continued bleeding of existing clients. The typical large firm (\$1 billion or more in AUM), added nine clients in the third quarter, and lost three clients in the same period. For mid-size firms the numbers were eight clients added and two clients lost. For small firms (under \$500 million in AUM), there was a median of three clients added and no clients lost.

Firms Find Traction with Wirehouse and Self-directed Clients

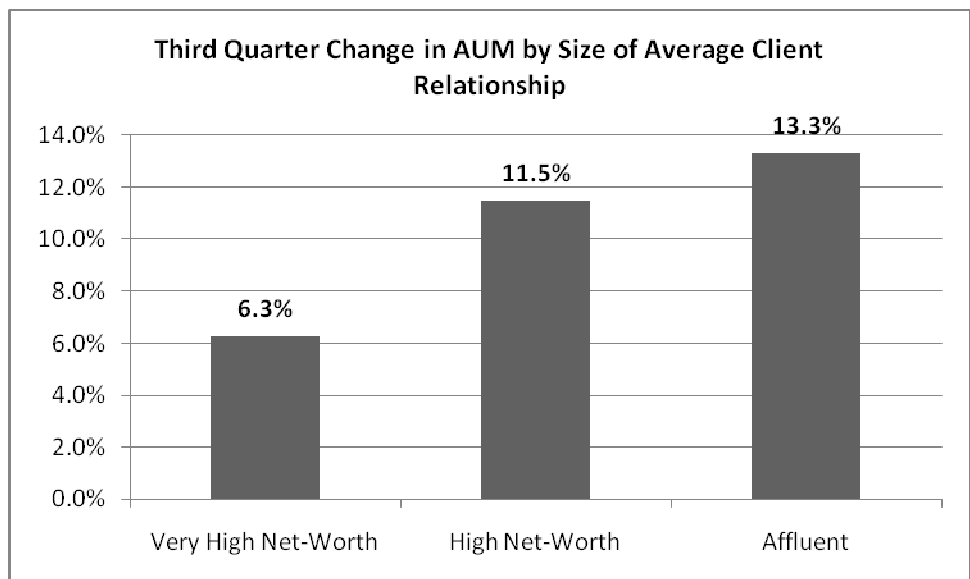
The majority of new clients came to independent wealth management firms either from wirehouses (40% of the total) or self-directed channels (25%). While the result varied somewhat by the size of firm, this was a function of the size of the client relationship rather than the size of the firm, as we will see in the next section.



It seems that independent wealth management firms continue to chip away at the market share of wirehouses and compete with each other relatively little. At the same time however, the process is somewhat slow. When losing clients, firms have lost them, most of all, to self-directed channels and to a lesser degree to other independent firms. Overall, for every client lost in the third quarter, firms added three clients. Still, the process is slow and it appears clients are still reluctant to make significant changes.

Clients between \$1 and \$10 million offer the most resilience

Every wealth management firm I have ever worked with is always in search of larger client relationships. Yet, it may be true that some of the not-so-large clients are offering wealth management firms more resilience and loyalty in a time of crisis.



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Firms that average more than \$10 million in AUM per client had the lowest percentage of growth in the third quarter and the steepest decline in the beginning of the year, compared with firms that work with clients averaging between \$10 million and \$1 million and firms that work with clients under \$1 million. Perhaps the sheer game of larger numbers favors business development focused on smaller relationships. There are more targets and perhaps a higher probability of success than the large relationships offer.

The firms that focus on the highest end of the market also benefit the least from professional referrals. They derive almost none of their opportunities from CPAs and other professionals and almost entirely rely on the relationships of their founders\principals and referrals from existing clients. It also seems that the majority of very high-net-worth clients came from banks—rather than wirehouses and self-directed individuals—as was the case with the smaller relationships.

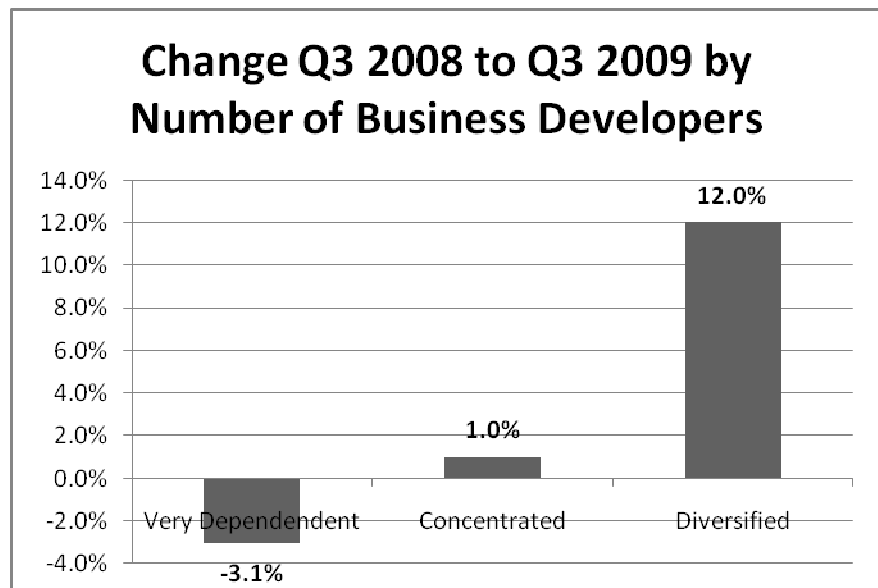
Firms relying on one or two individuals are slower to recover

Wealth managers have never been and have never wanted to be expert salespeople—most firms have always struggled, at least a little, to accelerate their growth and involve multiple people in the business development process. At the same time, they need the business development skills—now more than ever. It appears that firms that have diversified the responsibility to bring in new clients are faring much better than firms that have relied on the efforts of one or two individuals.

If we divide firms in the survey into three categories based on how many people are involved in the business development process we find that *firms that have more than five business developers have experienced the best results. Firms that have only one or two business developers have actually not been able to grow at all.*

Part of this result can be explained by the size of the

firm—after all, a firm with five or more business developers is most likely a large firm. At the same time though, if we look at the results strictly based on size there are no significant differences in the rate of growth of AUM, and in fact, if anything, smaller firms seem to be doing a little better. This leads us to believe that firms with multiple professionals who develop business (even if each of them develops and

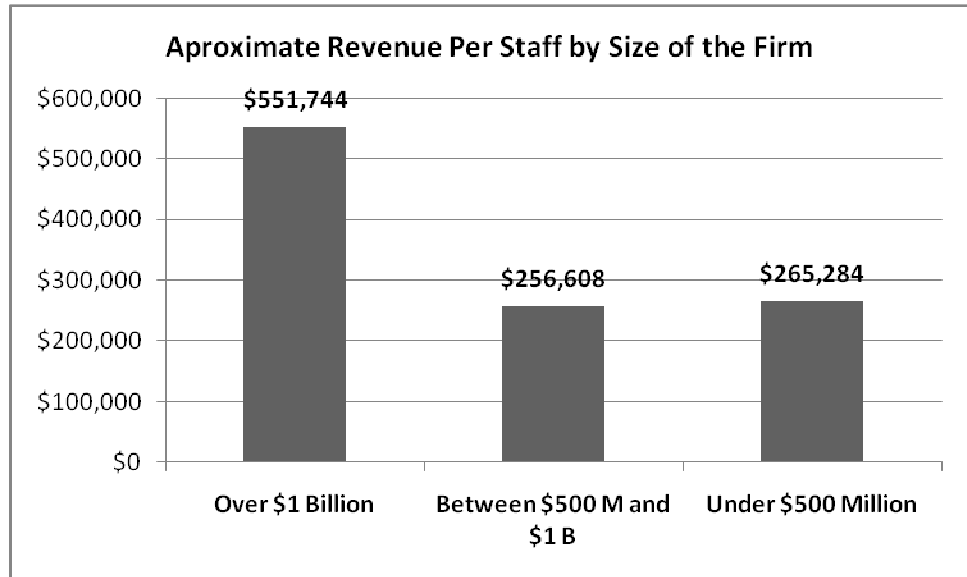


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manages less) are growing better than firms who only have one business developer, even if this business developer is achieving high individual productivity.

Productivity is still low across the industry

Staff productivity has always been a critical factor for the profitability of a wealth management firm. After all, staff expenses typically account for 75% or more of the total expenses. Before the crisis, staff productivity had grown to over \$500,000 per staff in the largest firms and over \$350,000 in the medium size and small firms.



Today productivity has taken a significant hit with medium-sized and small firms being close to the \$250,000 per staff that has traditionally been the minimum acceptable benchmark. This fall in productivity is a natural product of the fact that the number of clients is still relatively the same and that the activity in a firm is driven by the number of clients rather than the AUM. As a result, there is just as much activity (if not more) but the revenue is lower due to the decline in AUM.

Clearly, most firms have resisted over-reacting to the crisis and cutting staff significantly. While about 10% of the staff was lost in 2009 due to layoffs, it seems that firms have not reduced the staffing to a level that would bring the revenue per staff close to its pre-crisis levels. This decision to sacrifice short-term profits for the long-term growth and health of the firm is warranted: Firms that kept their capacity high recovered more successfully in the last recession of 2001 and 2002.

Motivating Employees in Tough Times

The year 2009 interrupted the natural development of the human capital at wealth management firms. Many firms had to go through painful layoffs and reductions in compensation. On average, the participants in the study had to lay off one professional and one administrative employee out of a staff of 16 people, reducing their total staff to 15 as of the end of September. What is more, many firms had to cut compensation for the staff that remained. As the end of 2009 approaches, wealth management firms are facing a difficult decision—on one hand they need to keep their staff motivated, on the other, they have less resources to do so.

On average, almost a quarter of all firms will simply not pay bonuses to staff. Another 5% are not likely to do so, given the existing formulas. At the same time the remaining 70% of

Are you likely to pay bonuses at the end of 2009?

No	24.5%
No, unlikely given the incentive formula	4.3%
Yes, significant discretionary bonuses	9.6%
Yes, but small discretionary bonuses	26.6%
Yes, likely to pay based on a formula	24.5%
Yes, discretionary but only to select employees	10.6%

firms are looking to find ways to compensate employees for their hard work in 2009, either through discretionary bonuses or through an adjusted formula.

What can you do?

What we believe we have learned from this data is that there are reasons to be optimistic about the future of the independent wealth management industry. We have recovered remarkably fast from the losses of the first quarter of 2009 and we are growing again. This growth, while still slow, is signaling that a bigger opportunity is still ahead. For us the lessons learned are:

- Prepare for the wave of recovery—The experience of the industry in the last recession (2001 and 2002) was that there was a wave of assets that came back to the markets and a wave of clients who changed advisors. That wave resulted in almost 40% growth in AUM in 2004. If the same pattern is repeated in this recovery we should expect the majority of the opportunity to concentrate in one big year—if a firm misses it, it will lose a lot of ground.
- Take care of your people—Opportunities are captured by people and this year, on average, participants in the survey cut down their staff by 9%. The remaining staff likely is not going to receive bonuses and raises in pay. At the same time, they will be the ones that should help the firm restart its growth.

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- Diversify your business development—Clearly firms that over-rely on one or two business developers have a harder time restarting growth. Setting many hooks in the water will help a firm get back on the growth track.
- Do not overshoot the target—Most wealth management firms try to position themselves to attract the highest-net-worth clients they can possibly get. At the same time, the data suggests that some of the best clients may be in the middle—between \$1 million and \$10 million. They may be more resilient and loyal in hard times than the ultra-high-net-worth segment that all firms covet.

The wealth management model is not one of big hits and spectacular quarters. It is a model built on the systematic accumulation of positive changes and a solid foundation of existing clients and relationships. Being systematic is the key to successful planning for 2010—systematically looking for opportunities, making sure they don't slip away and having confidence in your value proposition. We are growing again and we are looking at opportunities again. Being a business owner is a never-ending process of answering the difficult challenges that the external environment presents to us, even if it means chasing the rock down the hill again. A true business owner will not have it any other way.

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Appendix – Data Tables

All Survey Participants
AUM Data

	All Firms	
	Average	Median
AUM September 2009	\$914,907,153	\$208,393,093
AUM June 2009	\$846,825,133	\$186,628,202
AUM December 2008	\$804,737,005	\$192,308,414
AUM September 2008	\$899,279,830	\$209,400,000
Growth Quarter to Quarter - June to September	8.04%	
Growth Year-to-Date	13.69%	
Change Q3 2008 to Q3 2009	1.7%	
	Average	As %
June 2009 AUM	\$846,825,133	100.0%
Plus: New Clients	\$17,604,184	2.1%
Plus: New Contributions from Existing Clients	\$22,538,089	2.7%
Plus: Market Performance	\$57,532,200	6.8%
Less: Market Performance	\$0	0.0%
Less: Withdrawals	-\$22,298,180	-2.6%
Less: Lost Clients	-\$7,294,273	-0.9%
Ending AUM	\$914,907,153	108.0%

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All Survey Participants

Client Data

	All Firms	
	Average	Median
Clients on January 1st, 2009	269	192
Clients added	18	12
Clients lost	-10	-4
Clients on September 30, 2009	276	191
Net Change	7	-1
Clients June, 2009	274	191
Clients added	6	4
Clients lost	-2	0
Clients on September 30, 2009	276	191
Net Change	2	0
	Average	Median
Starting Employees	16	8
Plus New Professionals Added	1	0
Plus New Staff Added	0	0
Less Professionals Lost	-1	0
Less Staff Lost	-1	0
Ending Staff	15	8
Self-directed	25	
Wirehouse	40	
Bank	13	
Other Broker-Dealer or RIA	8	
Multiple Advisors	13	
Referred by Existing Client	53	
Referred by CPA	17	
Referred by Lawyer	6	
Referred by Bank	1	
Referred by Advisor	6	
Referred by Custodian	3	
From advertising and PR	10	
Other Source or Unknown Source	5	

All Survey Participants Client Data

All Firms

What changes to your fees are you planning to make in 2010? (More than one chg. possible)

Adjust Up Break Points on the Fee Grid	7.8%
Adjust Down Break Points on the Fee Grid	0.0%
Increase Use of Retainer	10.0%
Decrease Use of Retainer	0.0%
Increase Fee	7.8%
Lower Fee	1.1%
No Change	82.2%

Are you likely to pay bonuses at the end of 2010?

No	24.5%
No, unlikely given the incentive formula	4.3%
Yes, significant discretionary bonuses	9.6%
Yes, but small discretionary bonuses	26.6%
Yes, likely to pay based on a formula	24.5%
Yes, discretionary but only to select employees	10.6%

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All Survey Participants

Client Data

	All Firms	
	Average	Median
Third Quarter Change in AUM	11.6%	10.1%
Year To Date Change in AUM	3.4%	9.2%
Third Quarter Change in Clients	3.3	2.0
Ratio of Business Developers to Staff	4	3
AUM Per Business Developer	\$150,195,460	\$83,133,333
AUM Per Staff	\$44,936,454	\$32,037,500
Aproximate Revenue Per Staff	\$311,903	\$264,785
AUM Per Client	\$3,949,470	\$1,201,756
Count	95	