IMAP InvestTech: U.S. Advice Landscape and Technology

Jamie Wickham

13th November 2019

For wholesale clients only

U.S. Adviser Landscape and Trends

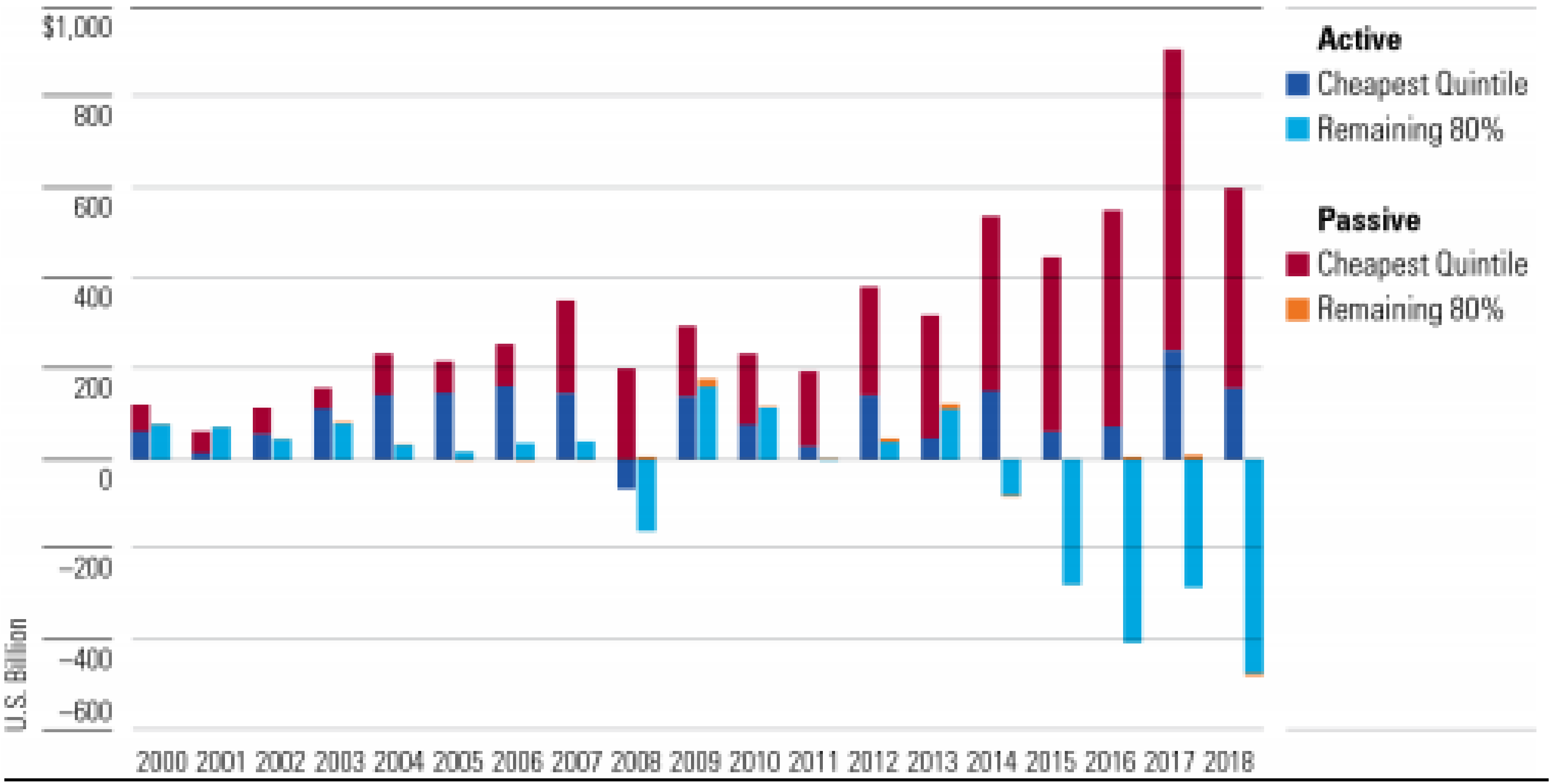
- RIAs continue to be the fastest growing part of advice segment
  - Shift from product sales to client-centric advice and acceleration of move to fee-based
  - Leading to fee pressure and unbundling
- Largest players disrupting the disrupters
  - Technology, scale and distribution
  - Hybrid Approach winning the day: digital and human interaction

Fee Pressure and Unbundling

Fee Pressure

- Unbundling
  - Asset management is being pried apart from distribution and advice
  - Hastened by regulation, this has spurred adoption of unbundled vehicles
  - Fund fees being displaced to pay for other services like advice

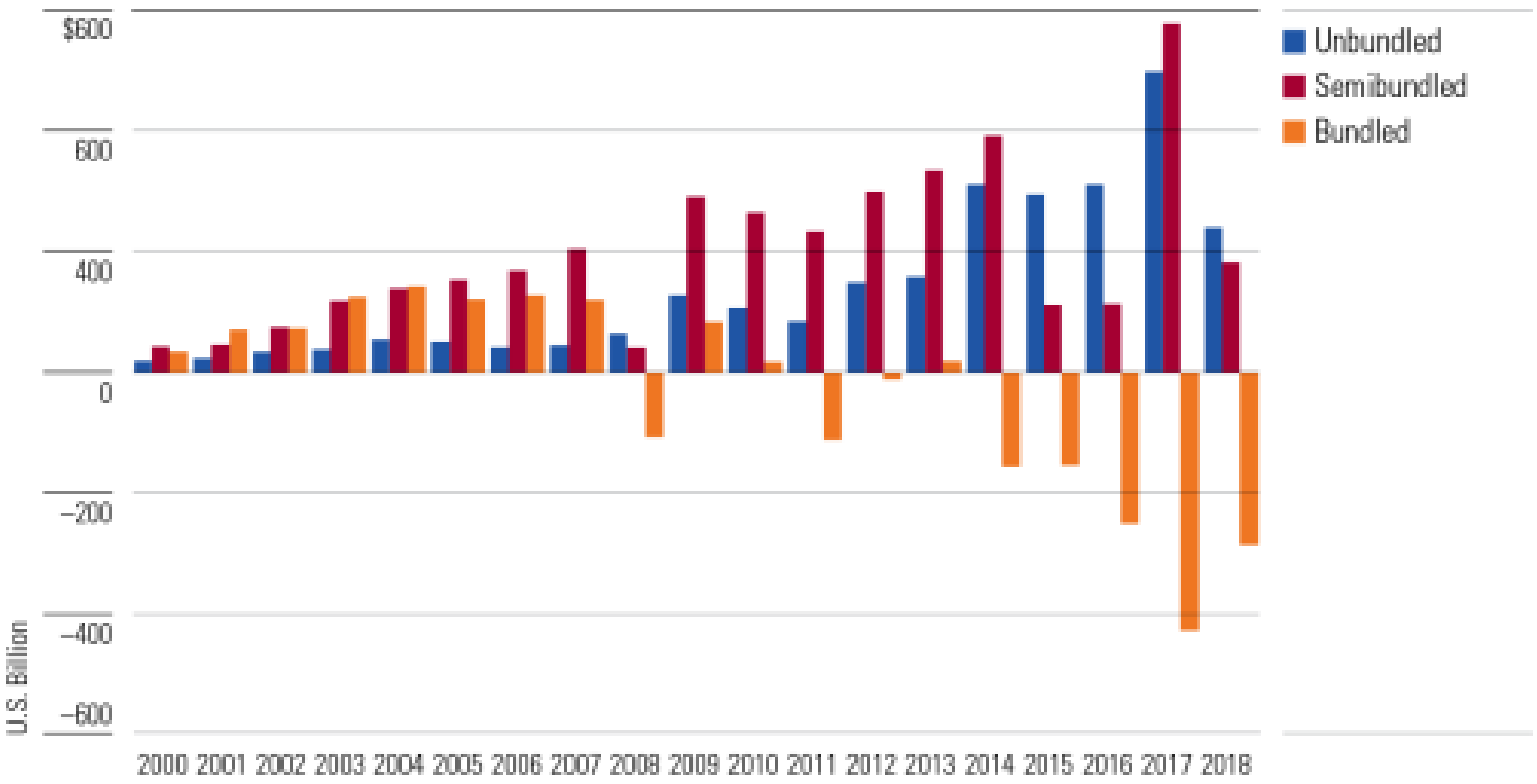
Driving Flows into Lowest Cost Products….



- The cheapest 20% of active funds have seen inflows

Source: Morningstar Direct

…and those where the distribution fee is unbundled



- A key distinction is bundled vs. unbundled

Source: Morningstar Direct

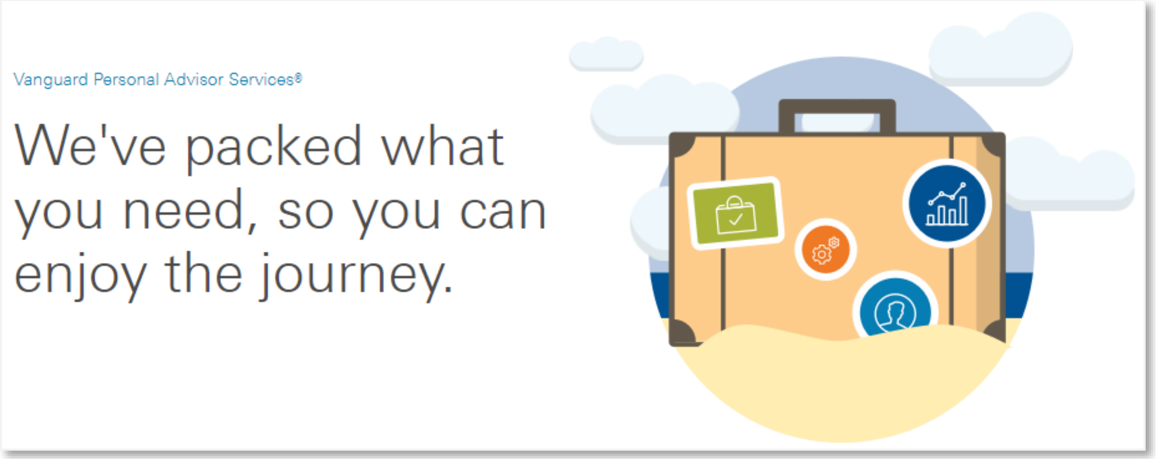
Largest Players Disrupting the Disruptors

Largest Players

- Owning the stack to own the customer. Technology enabled and low cost.
  - Asset managers deploying technology to envelop the client
  - Banks entering advice
  - Competition for customers driving down fees

Disintermediation

Product manufacturers leveraging their scale, hybrid advice proposition and diverse line-ups to direct-sell



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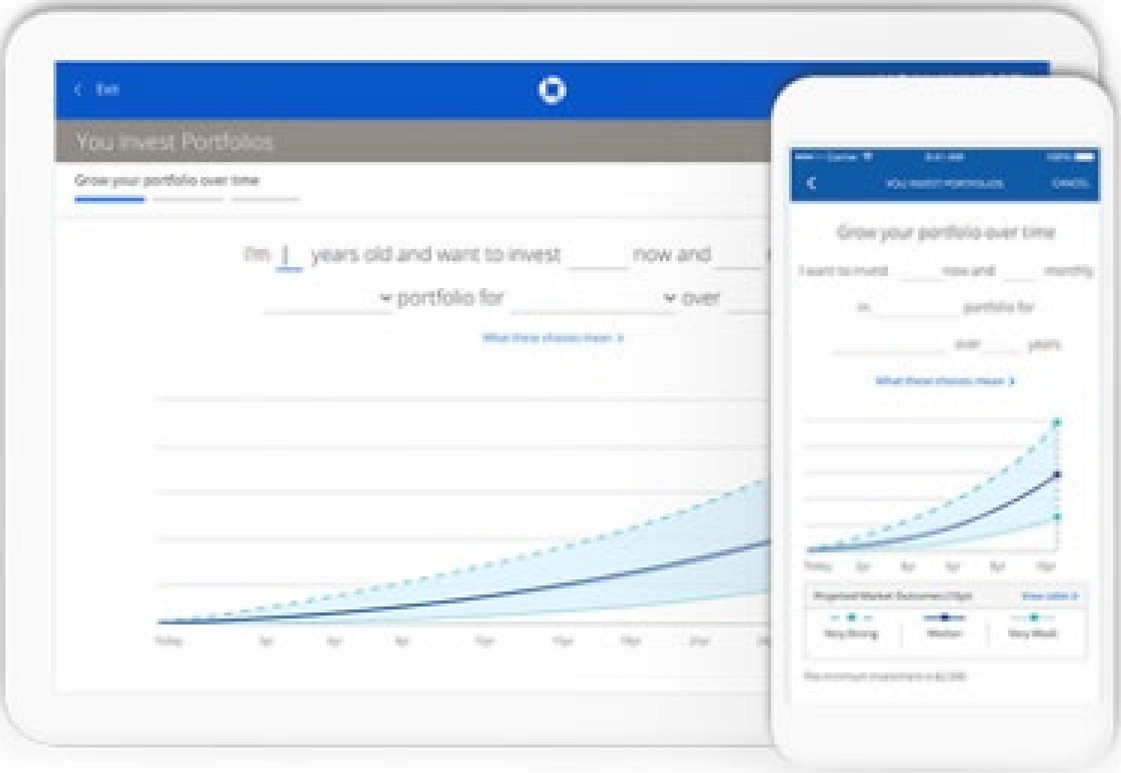
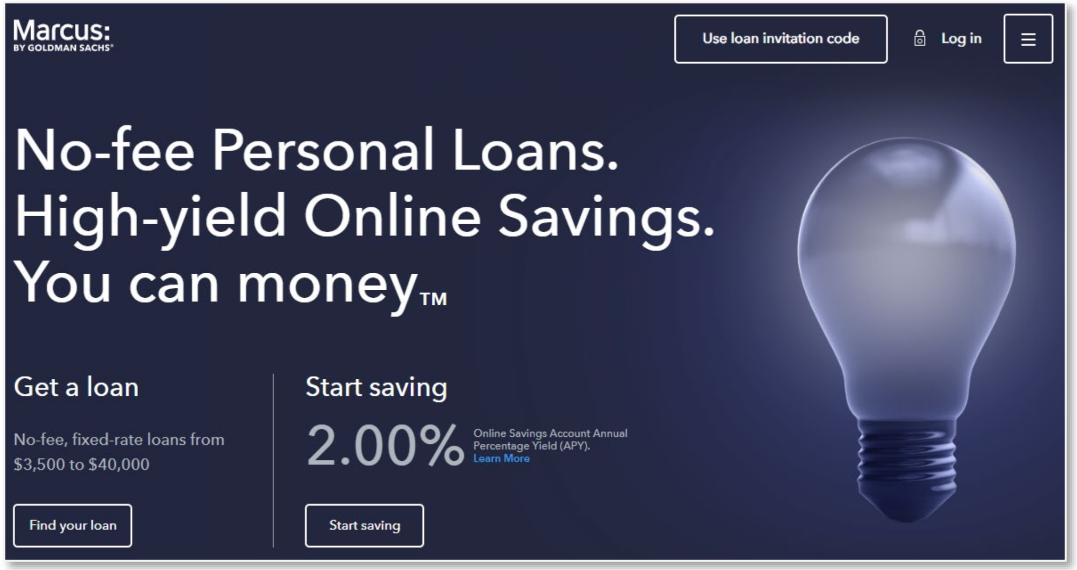
Banks Entering (Not Exiting) Advice

Leveraging their balance sheets, customer base and technology.





More competition. Lower Fees. Further Disruption.

"Freemium" models emerging—need scale, network effects to support a wealth-management ecosystem. Short term revenue hit for long term customer relationships.

JP Morgan is rolling out a robo-adviser with free ETFs to lure new investors

MARKETS BUSINESS INVESTING TECH POLITICS CNBC TV

ETF SPOTLIGHT

Fidelity's new no-fee index funds bring in $1 billion in first month

PUBLISHED TUE, SEP 4 2018 • 3:44 PM EDT | UPDATED WED, SEP 5 2018 • 4:43 PM EDT

Eric Rosenbaum
@ERPROSE

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KEY POINTS
- Fidelity Investments became the first financial company to offer no-fee index funds last month.

CNBC SIGN IN PRO WATCHLIST MAKE IT

MARKETS BUSINESS INVESTING TECH POLITICS CNBC TV

MARKETS

The latest in the brokerage wars: Charles Schwab will allow people to buy fractions of stocks

PUBLISHED THU, OCT 17 2019•2:22 PM EDT | UPDATED THU, OCT 17 2019•4:01 PM EDT

Morningstar’s Response

Leverage Our Strength in Data and Research

- Not just investment data and research
  - Client data alongside product data
  - Retirement research. Academic research on value of advice.
  - Behavioural science
- Insights from data and research surfaced in our software. Focus on design and user experience.

Research: Retirement and Value of Financial Planning

Journal of Financial Planning | Search Archives (Members Only) | About the Journal

The Value of Goals-Based Financial Planning

by David Blanchett, CFP®, CFA

David Blanchett, CFP®, CFA, is head of retirement research at Morningsta
Management. He is the 2015 recipient of the Journal's Montgomery-Wars
his May 2014 Journal paper "Exploring the Retirement Consumption Puzz

Executive Summary

- The financial planning profession is built on helping people accomplish g investing appropriately is generally an important part of accomplishing a g goal often requires advice beyond selecting investments based on alpha
- Past research on the topic of goals-based financial planning has focused determining optimal portfolios to fund different types of goals. In contrast, research is how to determine which goals should be funded, as well as h save toward goals over time.
- A utility model based on prospect theory was used to determine the optim strategy for a household.
- The results suggest that using a goals-based framework to determine wh and how to fund them can lead to an increase in utility-adjusted wealth of a hypothetical household versus a naïve strategy focused only on funding is equivalent to generating an annual alpha of 1.65 percent for the lifetim scenario household.

Goals-Based Risk: Updating financial planning to address both investment risk and behavioral risk

To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions, and the ability to keep emotions from corroding that framework.

-Warren Buffett

Executive summary

Understanding people's feelings about risk is important to help them succeed as investors in the long term – but this does not mean it's a good idea to put people's emotions in the driver's seat as they make important plans and financial decisions. An investment strategy should serve people by helping them reach their financial goals, while taking into account that emotions can yield risks of their own as people can sometimes act as their own worst enemies. This paper presents the Goals-Based Risk framework to address both investment risk and behavioral risk, each of which, if not dealt with effectively, can undermine an investor's long-term outcomes. It is a coherent approach to financial planning that replaces reliance on Risk Tolerance Questionnaires (RTQs). Goals-Based Risk is a behaviorally attuned approach and it is designed to help real people both plan and persevere in the face of market uncertainty.

Introduction

The finance industry faces a pragmatic concern: How should an advisor properly match a client to an investment strategy? In other words, how can an advisor create a portfolio that is good for a client? In this paper, we contend that goals should be the loadstar in the financial planning process and we develop a framework consistent with this orientation, called Goals-based Risk.

This goals-centric approach is not common industry practice. Instead, two distinct approaches have emerged. One uses a risk tolerance score (a rough proxy for an investor's anticipated emotions to volatility and losses) and uses this to direct the selection of an investment strategy.

CONTRIBUTIONS | Sin | Murphy | Lamas

Goals-Based Financial Planning: How Simple Lists Can Overcome Cognitive Blind Spots

Ryan O. Murphy, Ph.D.; and Samantha Lamas

Executive Summary

- Prior research has shown that behavioral biases may inhibit investors from identifying and prioritizing investing goals that are important to them.
- A nationally representative study was conducted to understand if a simple behavioral technique would nudge investors away from using unreliable, top-of-mind notions when it comes to creating investing goals; and if a more sophisticated technique is better at prioritizing investment goals than a simple one.
- Asking people to self-report their investing goals is insufficient. About 26 percent of the participants in the study changed their top goal when prompted with reminders about other goals.
- On average, using a more sophisticated ranking technique did not lead to any appreciable difference in how investment goals were ranked, suggesting that when it comes to prioritizing multiple goals, a straightforward rank ordering suffices.

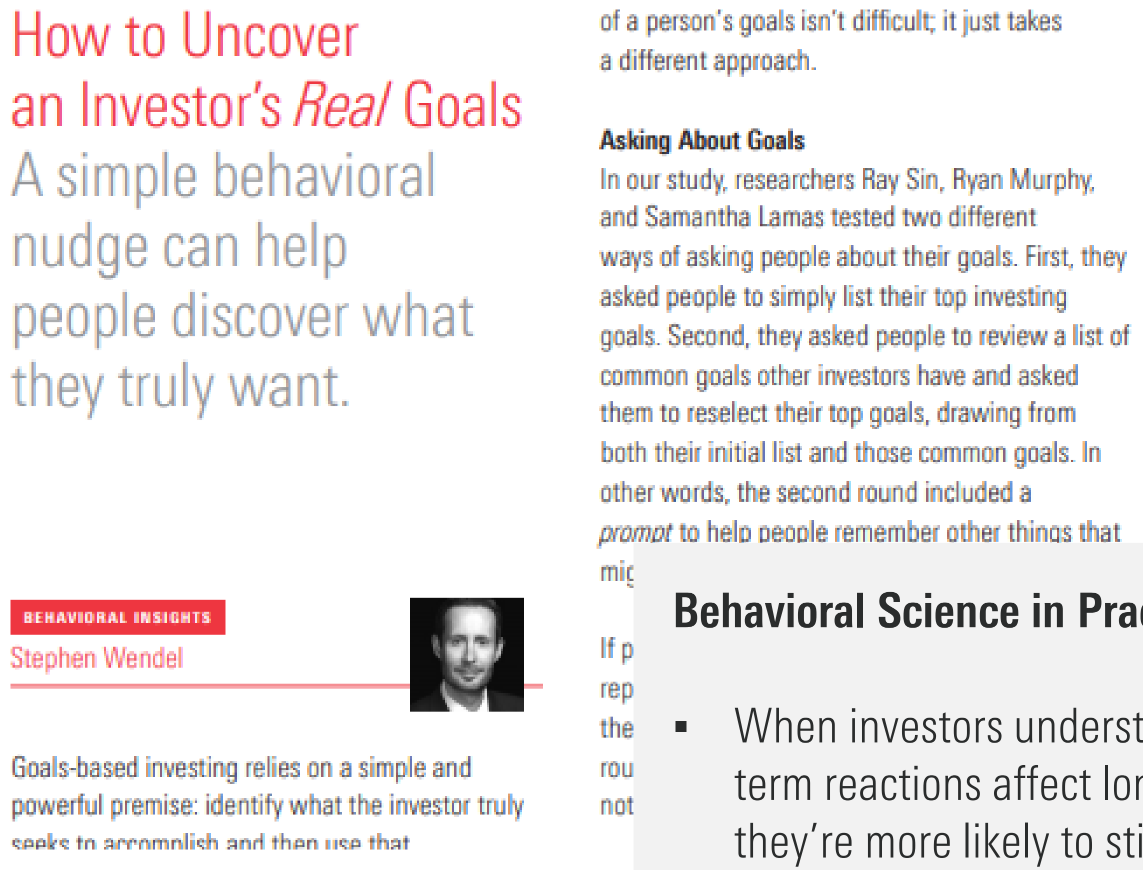
relationships.[1] As such, more planning professionals are practicing goals-based or goals-centric financial planning (Lee, Anderson, and Kitces 2015).

The success of goals-based planning hinges upon two important steps: (1) eliciting goals that are most important to investors; and (2) prioritizing those goals. Yet, behavioral biases may manifest and undermine the efficacy of goal-based financial planning.

Dual process theory (Stanovich and West 2000; Kahneman 2011) suggests that due to cognitive limitations, people often exhibit behavioral biases when it comes to decision-making. Although a wealth of research has documented how behavioral biases negatively impact financial decision-making broadly, compara- to understand how behavioral biases may affect goals-based financial planning. Are behavioral biases at play within the domain of goals-based financial planning, particularly in relation to goal elicitation and prioritization? What are some evidence-based tools financial planners can implement to help their clients overcome them?

This research comprises two studies. Study 1 proposes and presents the results of offering participants a worksheet—the master list—that planners may use to improve the goal-elicitation process. This master list differs from previous research on worksheets to better elicit goals (Diliberto 2006; Briaud 2002) in a few ways. First, the master list used in Study 1 draws from the behavioral

Behavioural Science: Nudges, Guidance and UX



How to Uncover an Investor's *Real* Goals

A simple behavioral nudge can help people discover what they truly want.

BEHAVIORAL INSIGHTS

Stephen Wendel

Goals-based investing relies on a simple and powerful premise: identify what the investor truly seeks to accomplish and then use that

of a person's goals isn't difficult; it just takes a different approach.

Asking About Goals

In our study, researchers Ray Sin, Ryan Murphy, and Samantha Lamas tested two different ways of asking people about their goals. First, they asked people to simply list their top investing goals. Second, they asked people to review a list of common goals other investors have and asked them to reselect their top goals, drawing from both their initial list and those common goals. In other words, the second round included a *prompt* to help people remember other things that mig

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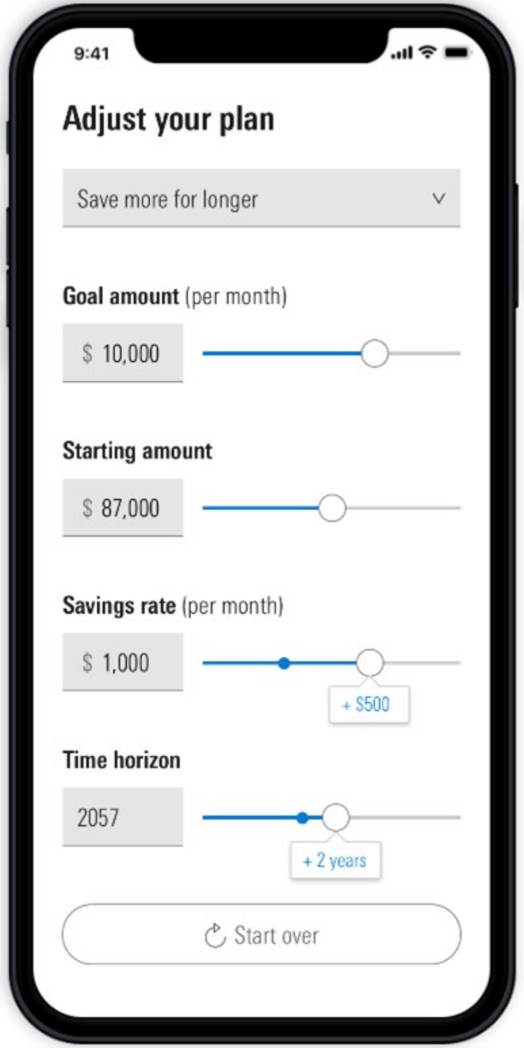
Behavioral Science in Practice

- When investors understand how short-term reactions affect long-term goals, they're more likely to stick with their investment strategy.



MORNINGSTAR

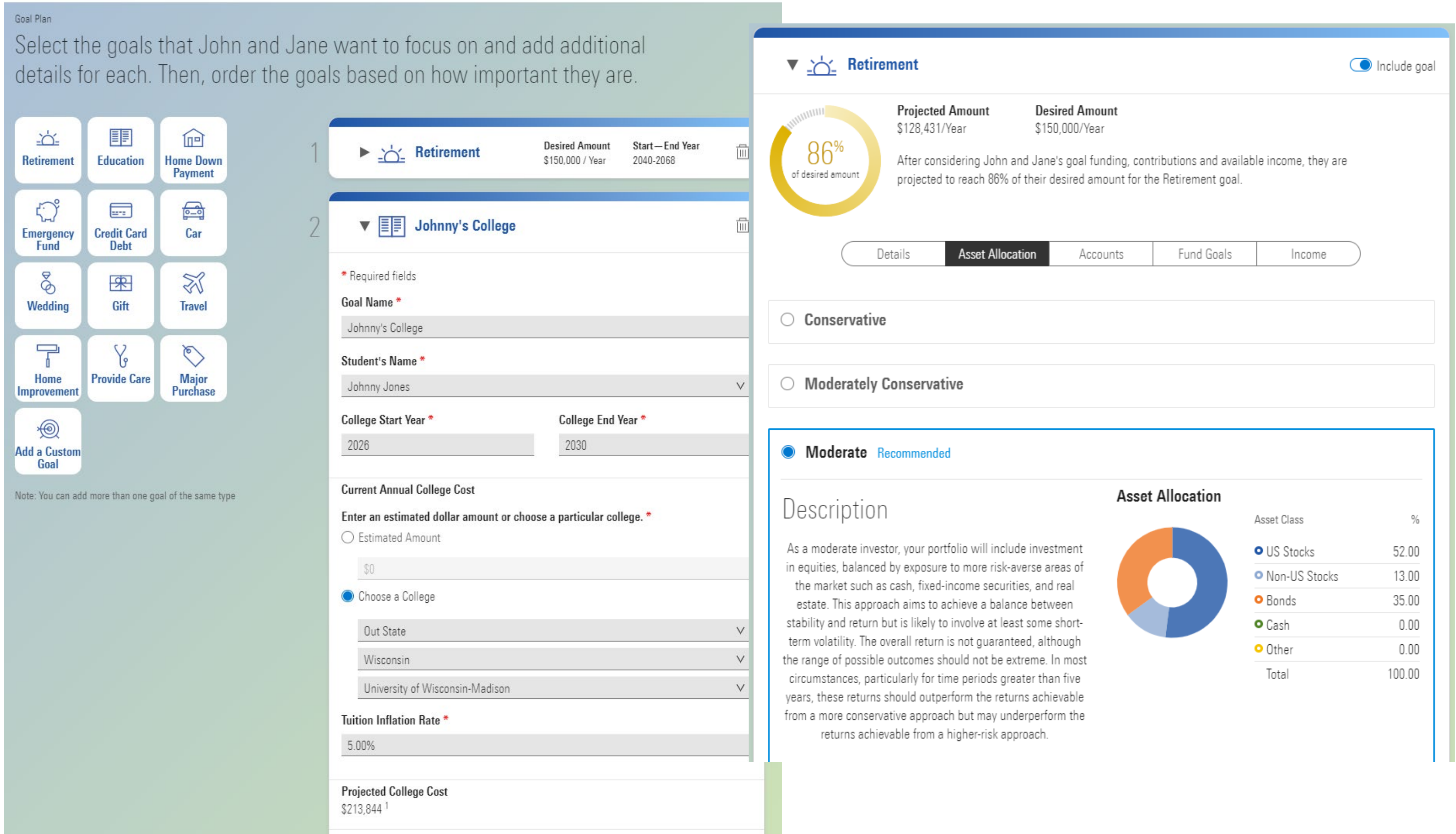
Focus on setting personal, meaningful goals as quickly as possible

Understand **clients' tolerance and capacity for risk**, goal by goal

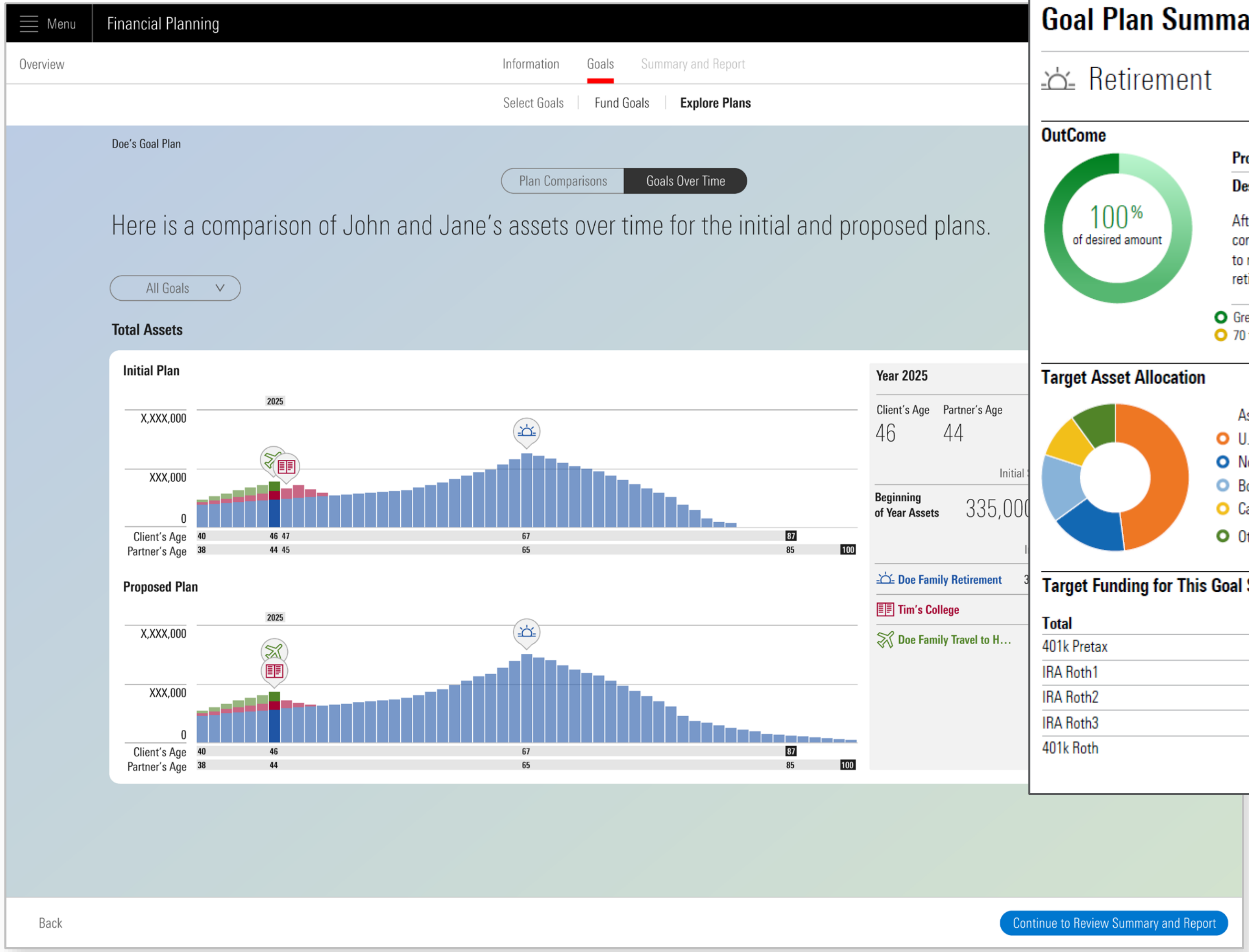
Power **investment plans and proposals** with **35 years of independent research & data**

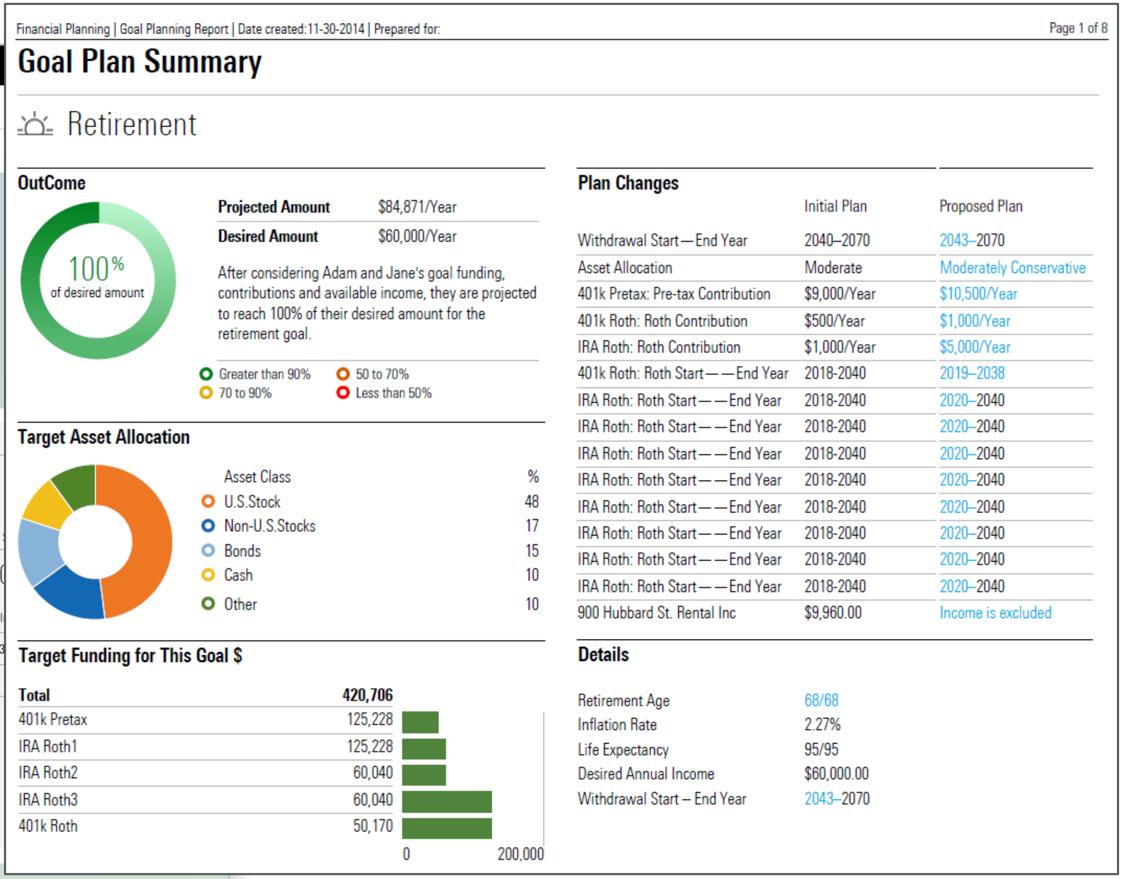
Goal Bridge connects goal planning to investment planning in one straightforward workflow

Goal Bridge Helps Clients with Goal Prompts and Personalized Goals



Establish Scenarios and Goal Plan Summary





Financial Planning | Goal Planning Report | Date created:11-30-2014 | Prepared for: Page 1 of 8

Goal Plan Summary

Retirement

OutCome

100% of desired amount

Projected Amount	$84,871/Year
Desired Amount	$60,000/Year

After considering Adam and Jane's goal funding, contributions and available income, they are projected to reach 100% of their desired amount for the retirement goal.

Greater than 90% · 70 to 90% · 50 to 70% · Less than 50%

Target Asset Allocation

Asset Class	%
U.S.Stock	48
Non-U.S.Stocks	17
Bonds	15
Cash	10
Other	10

Target Funding for This Goal $

Total	**420,706**
401k Pretax	125,228
IRA Roth1	125,228
IRA Roth2	60,040
IRA Roth3	60,040
401k Roth	50,170

0 200,000

Plan Changes

	Initial Plan	Proposed Plan
Withdrawal Start—End Year	2040–2070	2043–2070
Asset Allocation	Moderate	Moderately Conservative
401k Pretax: Pre-tax Contribution	$9,000/Year	$10,500/Year
401k Roth: Roth Contribution	$500/Year	$1,000/Year
IRA Roth: Roth Contribution	$1,000/Year	$5,000/Year
401k Roth: Roth Start——End Year	2018-2040	2019–2038
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
IRA Roth: Roth Start——End Year	2018-2040	2020–2040
900 Hubbard St. Rental Inc	$9,960.00	Income is excluded

Details

Retirement Age	68/68
Inflation Rate	2.27%
Life Expectancy	95/95
Desired Annual Income	$60,000.00
Withdrawal Start – End Year	2043–2070

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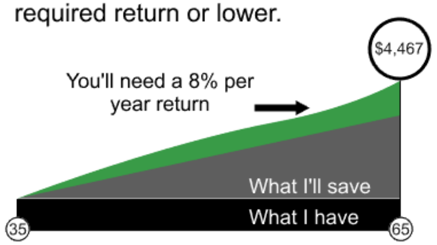
Next-Gen Risk Assessment

Make changes

To reach your goal with a required return to 8% or less:

• delay retirement until age 69
• or reduce how much you'll need in retirement by $600/month
• or save $350/month more

Adjust the dials until you find a good combination that gets you to the 8% required return or lower.



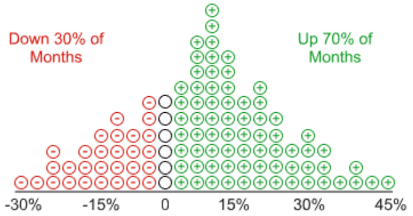
• Age you want to stop working: **[65]**
• How much you'll need: **[$4,467 per month]**
• How much you currently have: **[$100,000]**
• How much you'll be saving: **[$1,350 per month]**

Notice the user added $350 dollars per month

The ups and downs

The ups and downs

Here's what might happen over the lifetime of the portfolio.



Most of the time your returns will be in the range of -5% to 15%, but this portfolio is predicted to lose value about 30% of the time and gain value about 70% of the time.

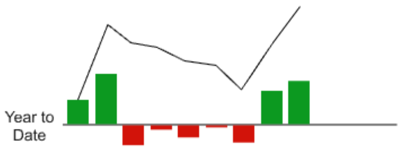
How comfortable would you be with losing value 30% of the time?

[ ] Very comfortable
[ ] Comfortable
[ ] Neutral
[ ] Uncomfortable
[ ] Very uncomfortable

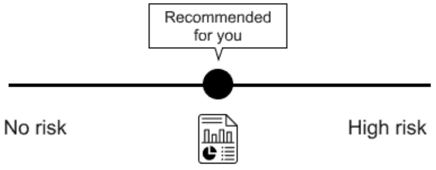
Continue animation

Test drive

September
You gained $25,037
Your balance is $156,813



Would you like to change the risk level of your portfolio?



Continue to October

Plans to Acquire AdviserLogic

Plans to Acquire AdviserLogic

In a shifting landscape where independence, open architecture and the provision of client-centric advice is the new standard, our vision is to enable the adviser with Morningstar's institutional grade capabilities—integrated data, analytics, research, asset allocation and software —and our trusted brand to deliver quality advice and empower investor success.

Why AdviserLogic?

Growing market share in IFA segment

Focused on advice process and user experience

Recognised for customer support, training and ease of use

Modern technology stack and client data aggregation capability

Speed to market

Complimentary Capabilities

KEY CAPABILITIES

adviserlogic	+	MORNINGSTAR®
CRM		Global Investment Data
Cash Flow Modelling		Global Investment Research
Financial Planning		Portfolio Analytics
Advice Documents & Compliance		Investment & Goal Planning
Revenue Management		Client Portal
Client Data Aggregation		Behavioural Science
AFSL Dashboards		Investor-Centric Mission and Brand

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