IAA Key Findings

2018 Executive Outlook Survey Report

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INVESTMENT ADVISER ASSOCIATION

CERULLI ASSOCIATES

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Key Findings

2018 Executive Outlook Survey Report

In the second survey partnership between Cerulli Associates and the Investment Adviser Association (IAA), executives provided their insight and outlook as it relates to their business strategies and strategic planning initiatives. Key themes included profitability measures, budgeting expectations, technology initiatives, and investment strategies.

The survey was conducted in the first quarter of 2018. Research participants through IAA's membership base included executives from both wealth management and asset management firms. For surveying purposes, wealth managers were defined as investment advisers to individual clients and/or small institutions, while asset managers counsel funds and/or larger institutional clients.

The profiles of participating firms in the 2018 research initiative were relatively consistent with the first Cerulli and IAA survey partnership in Q4 2016. In 2018, nearly two-thirds (63%) defined their firm as a wealth manager, while 28% self-identified as an asset manager. Several respondents defined themselves as other; however, in most cases, these firms operate as both wealth and asset managers due to advising a broad spectrum of clients ranging from individual investors to large institutions.

As observed throughout this paper, although many of the participating firms share common opportunities and challenges, specific firm attributes are widely diverse. Assets under management (AUM) among wealth managers ranges from $100 million to north of $10 billion, whereas asset managers' AUM reaches greater than $300 billion.

Across all participants, staffing headcounts range from a low of just four employees to a high of greater than 600. The average and median staff counts of 76 and 31, respectively, align relatively well with the 2016 survey population.

Currently, no firms anticipate decreasing their overall headcount over the next calendar year. Nearly 80% of firms anticipate increasing the number of talent. The 2018 headcount expectations are higher than in Q4 2016, presumably reflecting optimism about firms' business prospects and the economy. Focusing on the training, hiring, and retention of talent is key—it ranks among the top-three strategic priorities, measures of profitability, and areas to receive increased budgetary resources. There is also a direct correlation between the firms that expect to increase their in-house talent and those that expect to increase total AUM over the next three years. Firms expected to increase total AUM with respect to individual and institutional clients more than in the defined contribution space, both in general and compared with the prior survey.

Key Findings

EXHIBIT 1

Profile of Firms, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Wealth managers/investment advisers are defined as those counseling individual clients and/or small institutions, while asset managers/investment advisers counsel funds and/or large institutions.

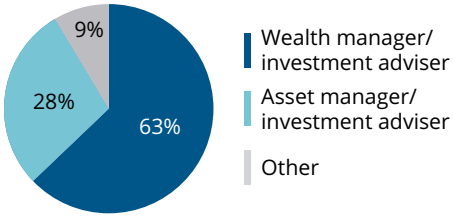


EXHIBIT 2

Current Headcount and Expected Change Over Next 12 Months, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: "Decrease by 1%–10%" and "Decrease by more than 10%" were options but were not selected.

	Current Headcount
Max	629
Average	76
Median	31
Min	4

Expected change over the next 12 months	
Increase by more than 10%	14.7%
Increase by 1%–10%	64.7%
Stay the same	20.6%

EXHIBIT 3

Markets in which Firms Offer or Plan to Offer Products and Services, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Market	In Market, Increasing Resources	In Market, Maintaining Resources	In Market, But Decreasing Resources	Plan to Enter in the Next 12 Months	Not in Market, No Plans to Enter
United States	60%	37%	3%	0%	0%
Europe	16%	16%	0%	3%	65%
United Kingdom	16%	13%	0%	3%	68%
AsiaPac	10%	16%	0%	0%	74%
Middle East	6%	13%	0%	0%	81%
Latin America	0%	3%	0%	0%	97%

EXHIBIT 4

Expected AUM Change Over Next Three Years, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Percentages may not sum to 100% due to rounding.

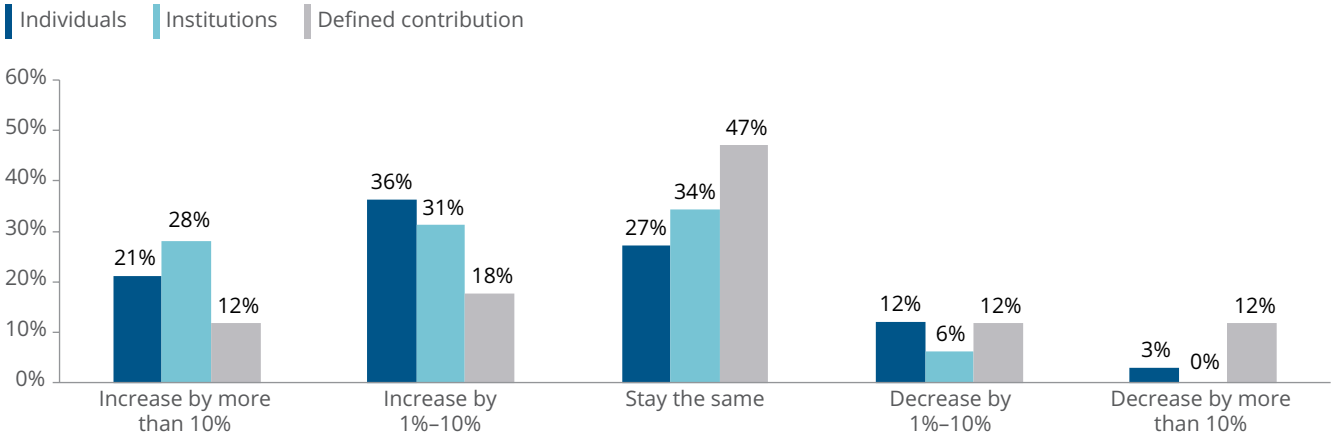
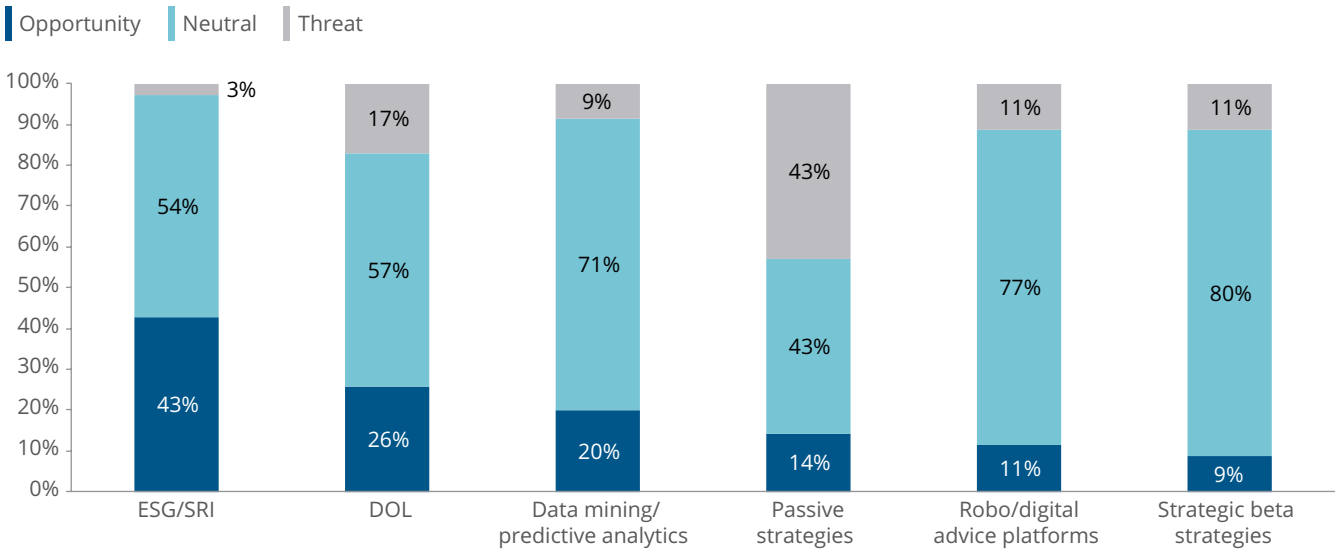


EXHIBIT 5

Industry Opportunities and Threats Over the Next Two Years, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Percentages may not sum to 100% due to rounding.



Ten percent more firms identified SRI/ESG as an opportunity in Q1 2018 than in Q4 2016 (43% vs. 33%). The ever-growing availability of data, talent, and processes continues to transform and evolve socially responsible investing (SRI) away from mere divestment in certain industries. Instead, firms are incorporating environmental, social, and governance (ESG) criteria across the entire universe of asset classes, investment regions, and investment structures. Interest in SRI may still outweigh actual flows into third-party funds, but Cerulli is confident that sustainable investing concepts will continue to gain momentum. The success will likely be accelerated by other secular trends in consumer behavior, especially among Millennial, Gen-X, and nonprofit investors.

Although the 2018 survey process closed before the Fifth Circuit voted to vacate the Department of Labor Conflict of Interest Rule (the "fiduciary rule"), the proportion of respondents perceiving the potential regulation as a threat still declined by nearly 10 percentage points since the 2016 survey. This is likely due to many firms having already prepared and/or implemented the necessary processes, especially those operating as retirement specialists. In fact, significant concerns related to domestic and non-U.S. regulatory environments rank relatively low compared to other potential external forces (see Exhibit 6) and lower than in 2016, though the level of moderate concern remains quite high. Because the survey closed before the SEC released its package of proposals related to the standards of conduct for advisers and brokers, regulatory concerns may have increased. Executives also indicated increased concern over geopolitical risks and some cited trade wars as another concern.

EXHIBIT 6

Level of Concern Regarding External Factors Over the Next Two Years, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Percentages may not sum to 100% due to rounding.

Factor	Not Concerned	Moderately Concerned	Very Concerned
Cybersecurity	3%	34%	63%
Potential significant market crisis	6%	69%	26%
International relations (*e.g.*, North Korea)	26%	51%	23%
Fee compression	17%	63%	20%
Competitive pressure to invest in new technology	34%	46%	20%
U.S. regulatory environment	14%	71%	14%
Non-U.S. regulatory environments	43%	49%	9%
Tax reform	57%	37%	6%
Globalization/ increased competition	57%	40%	3%
Brexit	65%	35%	0%

Key Findings

Despite recent market volatility and a nearly 10-year-old bull market, executives overwhelmingly identify cybersecurity as being the most concerning external threat. This is consistent with the IAA's 2017 Investment Management Compliance Testing Survey, which reflects that 86% of respondents identified cybersecurity as the most pressing topic. Cerulli's ongoing research discussions with independent RIAs confirm that the potential of digital theft of confidential client information is absolutely top-of-mind. These threats can be especially challenging for independent firms that do not have the support systems of larger middle and back offices. RIAs often rely on well-vetted third parties to coordinate their needed services.

Training employees to take precautions and implementing fundamental procedures, including antivirus software, firewalls, and password authentication (adviser- and client-facing) can be achieved at relatively low costs. However, with cyber threats consistently evolving as fast as the industry's technology itself, other aspects (*e.g.*, vendor management and incident response systems) are equally critical and costly.

The need for cybersecurity preparedness is high and recognized among leaders. Although executives rank cybersecurity as fifth in terms of overall budget expectations (see Exhibit 8), greater than half do plan to dedicate additional funds to the initiative. Moreover, the emphasis on cybersecurity is even greater than it first appears in the previous exhibit.

For example, when asked about technology-specific investments, nine out of 10 executives recognized it as either a moderate or high priority, with half naming it their highest priority. It outweighs other significant projects, including data/predictive analytics, updating older systems, digital content, and social media marketing. Fundamentally, these other initiatives are nice to have, but essentially useless, if the firms' and clients' sensitive data is vulnerable to breaches.

EXHIBIT 7

Priority of Technology Investments Over the Next 12 Months, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Percentages may not sum to 100% due to rounding.

	Not Applicable	Low Priority	Moderate Priority	High Priority
Improve cybersecurity	0.0%	8.6%	40.0%	51.4%
Improve data management/analytics	5.7%	17.1%	45.7%	31.4%
Update older technology	0.0%	17.1%	57.1%	25.7%
Maximize resource allocation and distribution opportunities (*i.e.*, client segmenting, predictive analytics)	11.4%	25.7%	45.7%	17.1%
Improve digital content (*i.e.*, mobile)	11.4%	25.7%	48.6%	14.3%
Artificial intelligence/data innovation	18.2%	45.5%	30.3%	6.1%
Implement regulatory/reporting requirements	2.9%	20.0%	71.4%	5.7%
Improve/build social media marketing strategy (*e.g.*, Twitter, LinkedIn)	8.6%	42.9%	45.7%	2.9%

EXHIBIT 8

Budget Expectations Over the Next 12 Months, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association
Analyst Note: Percentages may not sum to 100% due to rounding.

Budget Item	Not Applicable	Decrease	Stay the Same	Increase
Training/hiring/retention	0.0%	0.0%	32.4%	67.6%
Non-cybersecurity technology investment (*i.e.*, CRM, operations)	0.0%	0.0%	40.5%	59.5%
Customer service	0.0%	0.0%	43.2%	56.8%
Sales/distribution	2.8%	0.0%	44.4%	52.8%
Cybersecurity	0.0%	2.7%	45.9%	51.4%
Brand awareness	2.7%	0.0%	48.6%	48.6%
Product or service expansion development	8.1%	0.0%	51.4%	40.5%
Regulatory/legal/compliance	0.0%	2.7%	64.9%	32.4%
Market research	16.7%	0.0%	61.1%	22.2%

EXHIBIT 9

Top Strategic Priorities for Next 12 Months, 2018 vs. 2016

Sources: Cerulli Associates, in partnership with Investment Adviser Association
Analyst Note: Respondents were asked to select their top three priorities.

	2018	2016	Change (Percentage Points)
Customer service	57.1%	31.0%	26.1
Sales/distribution	48.6%	54.8%	-6.2
Training/hiring/retention	34.3%	21.4%	12.9
Succession planning	34.3%	38.1%	-3.8
Product or service expansion development	31.4%	42.9%	-11.5
Brand awareness	28.6%	26.2%	2.4
Non-cybersecurity technology investment (*i.e.*, CRM, operations)	22.9%	33.3%	-10.4
Cybersecurity	20.0%	16.7%	3.3
Regulatory/legal/compliance	11.4%	33.3%	-21.9
Market research	2.9%	0.0%	2.9

Overall, registered investment advisers are hyper-focused on quality staffing, ranging from training and retaining existing employees to attracting new talent. Greater than two-thirds of survey participants expect this to require significant investment over the next 12 months. Compared with 2016, this has increased by greater than 63%, or 13 percentage points.

What should not be overlooked is the positive impact that hiring, retaining, and appropriately training the best talent can have on the other attributes outlined here (*e.g.*, customer service—the focus on which as a top strategic priority increased significantly since Q4 2016, sales, succession planning, and compliance). As the following exhibits highlight, the need to develop the next generation of talent remains particularly important.

EXHIBIT 10

Importance of Initiatives on Profitability of Firm, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

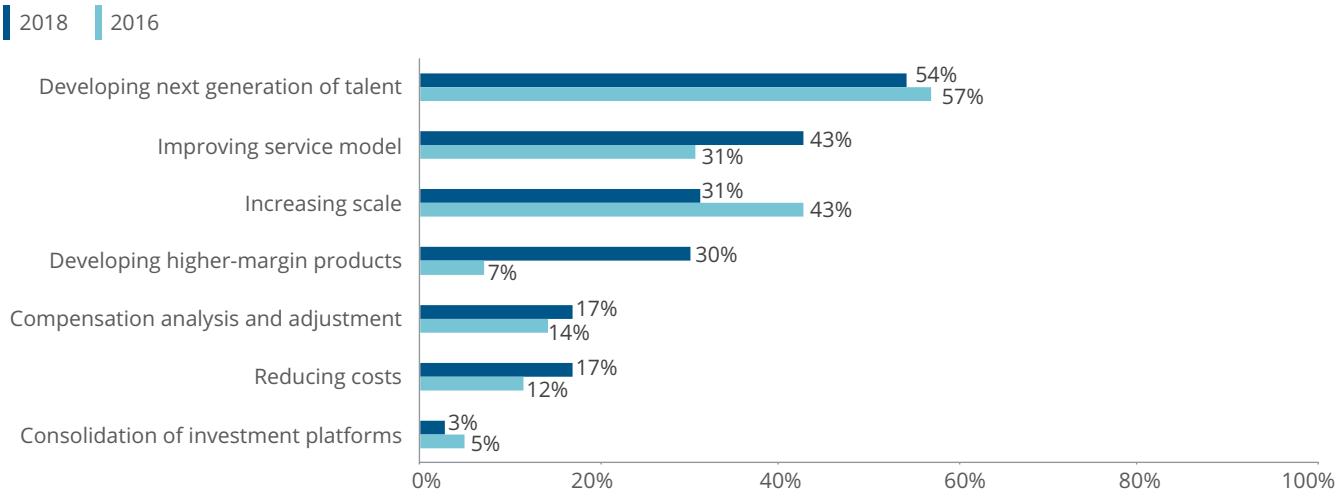
Analyst Note: Percentages may not sum to 100% due to rounding.

	Not Important	Moderately Important	Very Important
Developing next generation of talent	2.9%	42.9%	54.3%
Improving service model	14.3%	42.9%	42.9%
Increasing scale	8.6%	60.0%	31.4%
Developing higher-margin products	40.0%	30.0%	30.0%
Reducing costs	20.0%	62.9%	17.1%
Compensation analysis and adjustment	40.0%	42.9%	17.1%
Consolidation of investment platforms	74.3%	22.9%	2.9%
Developing passive/low-fee products	100.0%	0.0%	0.0%

EXHIBIT 11

Importance of Initiatives on Profitability of Firm, 2018 vs. 2016

Sources: Cerulli Associates, in partnership with Investment Adviser Association



According to other Cerulli data points, independent RIAs now claim 12% marketshare of the industry's total adviser headcount. This exceeds 20% when including hybrid (*i.e.*, dually-registered) RIAs. Across all intermediary channels, RIAs have dominated adviser headcount growth over the last one, five, and 10 years. Cerulli expects this trend to continue. Combined, independent and hybrid RIAs are projected to claim 23% of all advisers by year-end 2021.

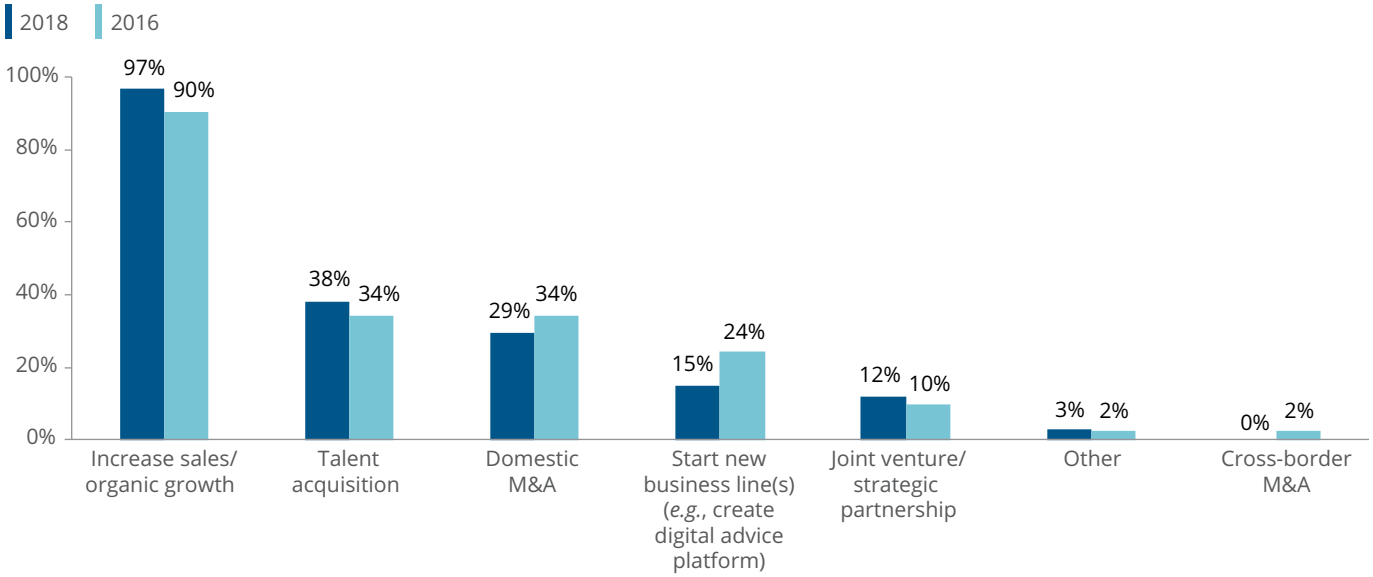
However, a major challenge to which even the growing RIA channel is not immune is *retirement*. Nearly half of all RIA advisers are self-reportedly within 15 years of retiring and nearly one-quarter are within 10 years. This has helped fuel two major trends in the space.

The first is the team-based approach of providing advice. Teaming can improve client experience, increase economies of scale, enrich services and expertise, and solidify succession planning. The second is the hiring of the next generation of talent. Many firms believe hiring younger employees is an advantageous way to engage the heirs of current clients (*i.e.*, retain family assets). However, more recognize that it's a critical component to business continuity planning regardless of whether the junior talent or existing senior partners are currently slated to succeed today's leaders.

EXHIBIT 12

Growth Plans Over the Next 12 Months, 2018 vs. 2016

Sources: Cerulli Associates, in partnership with Investment Adviser Association



As outlined in Exhibit 4, greater than half of all surveyed firms expect to increase their AUM across individual and institutional clients over the next three years. Virtually all expect to accomplish this by way of organic growth. Cerulli finds this is a common characteristic in the entrepreneurial environments of most RIAs. However, the lines become blurred when migrating advisers are considered. RIAs continue to attract experienced advisers relocating from other intermediary channels. Depending on the business model of the benefiting RIA, this could be categorized as either organic or inorganic growth.

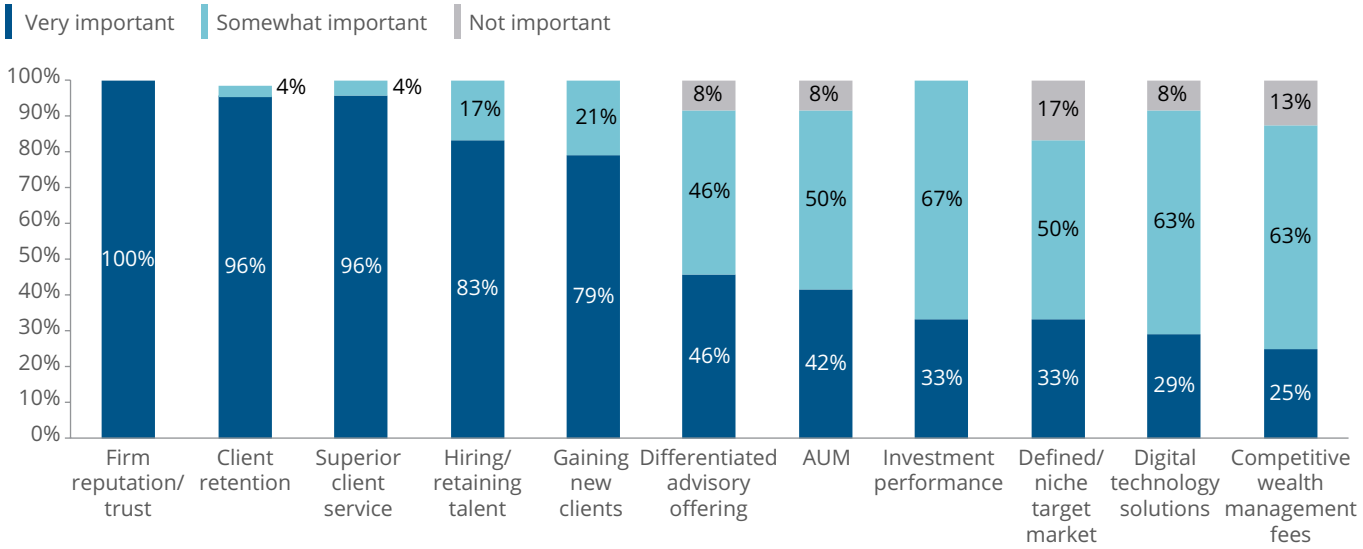
Overall, Cerulli anticipates that new business lines, including digital advice platforms and automation tools, will have a greater impact than many currently expect. Technology is already proving valuable in attracting new clients as well as streamlining services among existing clients who either require fewer resources or may be less profitable. Other clients may not yet be ideal fits for the firm's expertise or meet minimum asset requirements, but have future potential to do so. These initiatives allow many firms to emphasize organic growth by focusing on fewer, wealthier, and more profitable clients.

EXHIBIT 13

Factors That Determine Success of Wealth Management Business, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Data represents responses from wealth managers/investment advisers, which are defined as those counseling individual clients and/or small institutions. Percentages may not sum to 100% due to rounding.



Cerulli expects mergers and acquisitions (M&A) to play an increasingly important role in many RIAs' growth strategies. With nearly half of all RIA advisers within 15 years of retirement, one in five expect to sell their practice to an external party and a similar amount are "unsure of their succession plan." Emotional aspects of transferring clients to a new adviser, finding a qualified buyer, and fairly valuing a practice are named as the three largest challenges in the planning. Ultimately, many may find themselves being more comfortable selling to another RIA, versus a bank or large B/D.

Cerulli highlights this because succession planning is one of the largest challenges facing the entire industry. For those looking to grow their practices, consideration of M&A will likely rise, but there are major challenges to consider—especially as it relates to the top factors demonstrated here. Beyond just valuation and negotiation concerns, the acquirers need to consider potential style differences, client types, onboarding/transitioning clients, and the time commitment and resources needed to finalize a deal.

If client types, human capital, and investment philosophies are culturally aligned, the acquirer can quickly achieve economies of scale. If not, the very factors that they embrace as determining the success of their practice can be devastatingly impacted. A rushed or incompatible acquisition can easily threaten the firms' reputation, client retention rates, ability to service clients, and retention of both preexisting and newly acquired talent.

It is gratifying, but not surprising, that 100% of the firms responding cited firm reputation and trust as very important in determining the success of their businesses. Firms view client retention and superior client service—quality-related measures—as more important to success than quantitative measures such as AUM, performance, and fees. Interestingly, less than half of respondents believe that a differentiated advisory offering is very important to business success.

EXHIBIT 14

Amendments to Stated Advisory Fees Over the Past Three Years, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Data represents responses from wealth managers/investment advisers, which are defined as those counseling individual clients and/or small institutions.

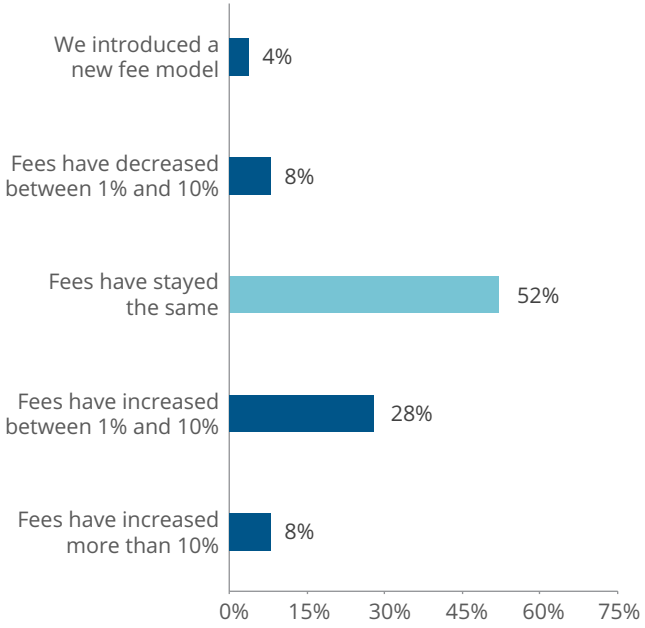


EXHIBIT 15

Interest in Investing in the Following Strategies Over the Next 12 Months, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Data represents responses from wealth managers/investment advisers, which are defined as those counseling individual clients and/or small institutions.

	Currently Using in Client Portfolios	Very Interested	Moderately Interested	Not Interested
Multi-asset-class solutions	48.0%	4.0%	16.0%	32.0%
Alternative/ nontraditional asset classes	44.0%	8.0%	16.0%	32.0%
Custom/ outcome-oriented solutions	36.0%	8.0%	20.0%	36.0%
SRI/ESG	25.0%	8.3%	29.2%	37.5%
Passive/low-fee solutions	24.0%	4.0%	28.0%	44.0%
Retirement income solutions	16.7%	20.8%	25.0%	37.5%
Smart beta solutions	4.0%	0.0%	24.0%	72.0%

With the success of passive investing, exchange-traded funds (ETFs), and strategic beta, it is not surprising that most respondents have some level of concern about fee compression (see Exhibit 6). However, while fee *awareness* is real, fee *compression* continues to be exaggerated at the wealth management advisory practice level.

The fact is, data illustrates that most wealth managers, including RIAs, have either left their fees unchanged or increased their fees. As exhibited here, just 8% of RIAs have decreased their fees. Moreover, of all the high-net-worth practices surveyed independently by Cerulli since 2013, just 13% have decreased their fees, while 28% increased. This may reflect that investment advisers are adding value to their clients in many ways, for example, providing concierge services or a wider range of planning capabilities.

Of those surveyed here that did increase their advisory fees, the two most common reasons were to offset increased regulatory/compliance costs and to remain in line with competition. By contrast, many that have decreased or kept fees consistent attribute it to efficiently implementing technology, outsourcing various services or processes, and leveraging their assets to gain access to institutionally-priced mutual funds and separate accounts.

Although not shown here, asset managers were asked a similar question to that in Exhibit 15 in terms of their interest in product development, which provided noteworthy insights. Unfortunately for many asset managers, their product development interests are not necessarily aligned with wealth managers' demand.

For example, half of surveyed asset managers currently offer, or have high interest in developing, SRI strategies, while nearly all indicated little (if any) interest in retirement income solutions and passive/low-cost solutions. Conversely, wealth managers are generally mixed and/or undecided on third-party SRI solutions, but remain interested in implementing more retirement income and passive solutions into client portfolios.

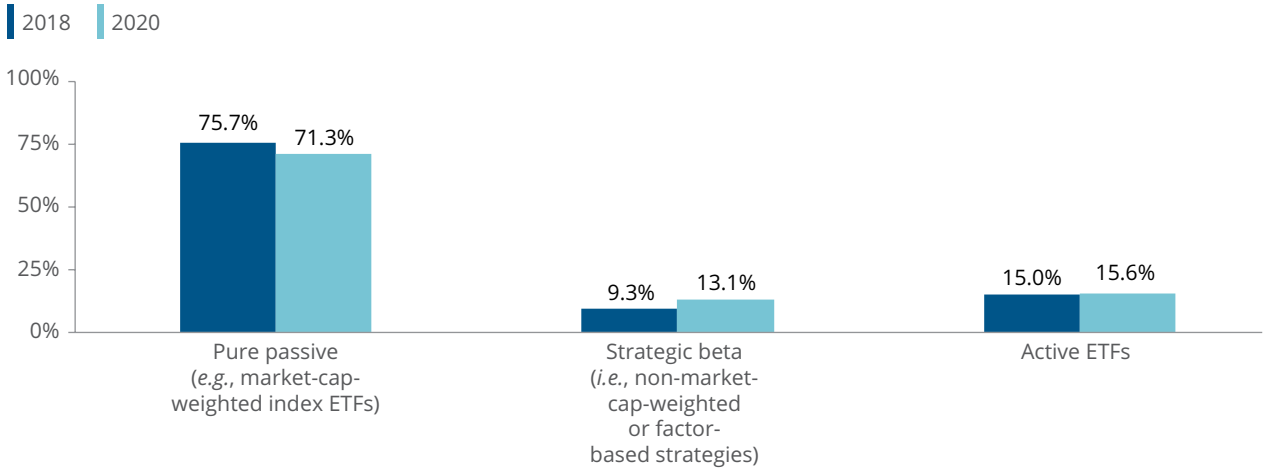
Cerulli believes that asset managers must ensure that they are adapting alongside wealth managers and their clients' evolving needs. ETFs are not the only opportunity. Retirement income solutions appear to offer a significant opportunity, yet 80% of asset managers responding noted having no interest in constructing an offering.

EXHIBIT 16

Current vs. Anticipated ETF Allocations by Strategy, 2018 vs. 2020

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Data represents all firms' responses that currently allocate client assets to ETFs.



ETFs continue to gain traction among RIAs of all sizes, including those on the highest end that meet Cerulli's definition of a multi-family office. Like passive ETFs, practices are incorporating strategic beta ETFs in a variety of ways, and in doing so are reducing overall portfolio costs. Given its low cost and tax efficiency, Cerulli believes the strategic beta concept will continue to gain momentum and prove to be a suitable building block for many clients' asset allocation strategies. Indeed, the respondents that use ETFs (fewer than half the respondents) expect allocation of pure passive to decrease by 2020 in favor of strategic beta.

Cerulli expects purely passive ETFs to retain the dominant share of ETF assets, but asset managers should continue to consider strategic beta options to complement their current offerings.

EXHIBIT 17

Implementation of ESG/SRI Strategies in Client Portfolios, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Data represents all firms' responses. "Do not currently use but have used in the past 12 months" and "Currently use and expect to decrease use over next 12 months" were options but were not selected.

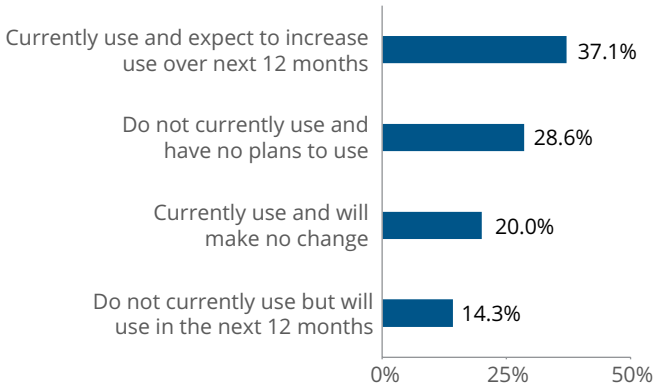
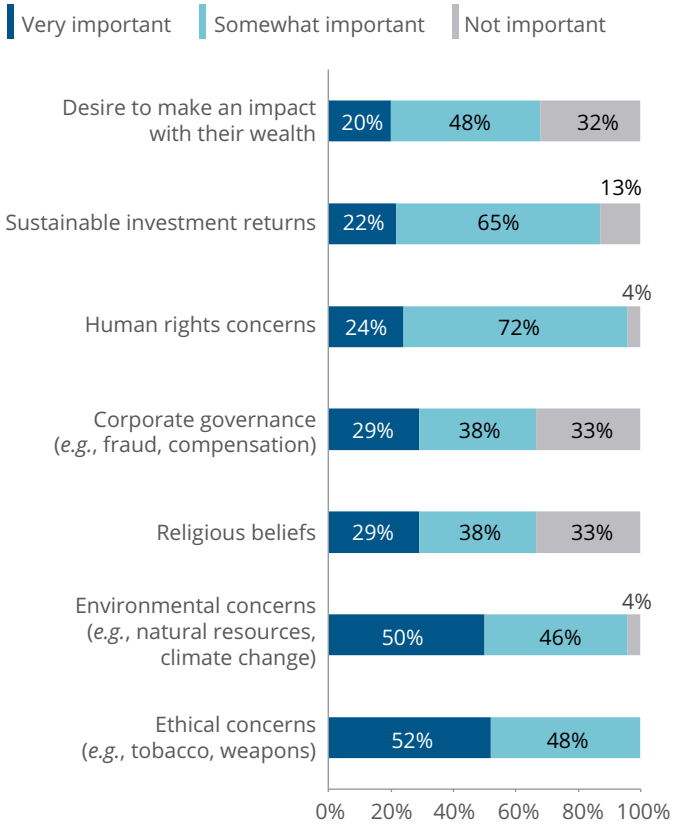


EXHIBIT 18

Clients' Motivations for ESG/SRI Strategies in Portfolios, Q1 2018

Sources: Cerulli Associates, in partnership with Investment Adviser Association

Analyst Note: Data excludes respondents that do not currently use and have no plans to use ESG/SRI strategies in client portfolios. Respondents were asked, "Which of the following factors are motivating your clients' interest in socially responsible/impact investing?"



As noted in Exhibits 5 and 15, interest and actual use of SRI strategies among RIAs is growing. Over time, interest may prove encouraging beyond next-generation and nonprofit investors. Cerulli's separate data demonstrates that female investors and beneficiaries of multi-generational wealth families are expressing mounting interest in making a positive impact with their wealth.

As a result, like asset managers interested in the space, many practices are trying to attract the talent and processes needed to address these investors' values and aspirations. Common themes include ethical concerns, clean energy, gender equality, and human rights.

Overall, SRI solutions make up a small portion of RIA assets, but Cerulli is confident that momentum will grow and ESG criteria will become a common thread that runs through client portfolios, potentially across all asset classes and vehicles. The question is whether third-party asset managers can convince practices to adopt pre-packaged solutions. For many high-end firms, the investing principles are long-established and embedded in their DNA and further customized by client-specific investment policies. ◆

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