INVESTOR PREPAREDNESS AND DECISION-MAKING

By Ed Louis, Senior Analyst, Wealth Management, Cerulli Associates

In this edition of Investments & Wealth Research, Cerulli Associates explores investors’ thoughts around investment decision-making. As the world grapples with the impact of the COVID-19 pandemic, investors are attempting to navigate unprecedented levels of financial and economic uncertainty. Fortunately, most investors (apart from true do-it-yourselfers) appreciate the guidance and support that can come from working with wealth management professionals. Although advisors have had to make changes in how they interact with clients and prospects, they can and in most cases are delivering on this value proposition at a crucial time.

FIGURE 1
INVESTORS’ RECESSION PREPAREDNESS, 2019–2020

FIGURE 1 HIGHLIGHTS: One-quarter of investors feel they are very well prepared for a potential recession.

KEY IMPLICATIONS: Investors who had a financial advisor during the 2008–2009 recession generally felt well prepared for it when it arrived. This continued through the onset of the COVID-19 pandemic, with investors feeling even better prepared than they were a decade ago. This confidence is a testament to the ability of financial advisors to prepare clients for potential market downturns and effective management when in the middle of them, a key aspect of an effective advisory relationship that goes beyond just portfolio management. It is important, however, to recognize the fact that as the pandemic has worn on, it has not financially impacted all investors equally.

Even if contact is limited, giving investors the ability to seek just-in-time guidance during periods of economic instability remains crucial to maintaining existing relationships.
TABLE 1
MARKET VOLATILITY PREPAREDNESS BY ADVICE ORIENTATION, Q2 2020

TABLE 1 HIGHLIGHTS: Investors in advisor-directed relationships are the most likely to feel prepared for market volatility.

KEY IMPLICATIONS: Investors in advisor-reliant relationships reported higher levels of volatility preparedness than those in less-reliant relationships. This is a key advantage for in-person (or as in-person as possible given social distancing guidelines) relationships given the advisor’s role in assisting clients with their full financial lives, choosing to focus on long-term horizons via goal planning and diverse investing instruments that can handle low- and high-volatility markets. This focus remains important and can serve as an opportunity to introduce lesser known or asked about solutions such as annuities and long-term life insurance to safeguard assets from wild market swings.

| How well do you feel that your advisor and/or other financial professional(s) have specifically prepared you for heightened market volatility? | Q2 2020 |
|---|---|---|---|---|
| Self-Directed | Advice for Special Events | Advisor-Assisted | Advisor-Directed |
| 1 (Not at all prepared) | 2% | 5% | 3% | 1% |
| 2 | 5% | 7% | 9% | 5% |
| 3 | 34% | 30% | 20% | 20% |
| 4 | 40% | 39% | 39% | 31% |
| 5 (Very well prepared) | 19% | 20% | 30% | 43% |

**Average Score**

| | 3.7 | 3.6 | 3.9 | 4.1 |

**Analyst Note:** Respondents in financial advisory relationships were asked, “How well do you feel that your primary advisor has prepared you for heightened market volatility?” Questions were asked on a 1–5 scale with 1 being “Not at all prepared” and 5 being “Very well prepared.” The color heat map is based on how prepared each investor segment felt for heightened market volatility. Dark red indicates the smallest share of the segment and dark green indicates the largest share of the segment for each preparedness level.

Sources: Phoenix Marketing International, Cerulli Associates

TABLE 2
COVID-19 STATEMENTS BY ADVICE ORIENTATION, Q2 2020

TABLE 2 HIGHLIGHTS: Nearly six in 10 respondents in advisor-directed relationships report greater long-term financial concerns, yet fewer than four in 10 report increasing communications with advisors.

KEY IMPLICATIONS: Even though a majority of investors report being more worried about their long-term financial security, fewer than four in 10 report they have increased their advisor communications. Particularly in an advisor-directed relationship, these conversations can reassure investors of their long-term goals and financial stability, and provide mental ease in uncertain times. Considering the limited ways advisors and clients can communicate because of public safety precautions, advisors should proactively inform clients about the best ways to reach out, either online or over the phone, as well as provide timely market updates and information that puts current market activity into proper, long-term context.

**Households that agreed with the following statements about the COVID-19 pandemic**

<table>
<thead>
<tr>
<th></th>
<th>Self-Directed</th>
<th>Advice for Special Events</th>
<th>Advisor-Assisted</th>
<th>Advisor-Directed</th>
<th>All Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investors like me should be carefully reviewing their finances and investments right now.</td>
<td>69%</td>
<td>77%</td>
<td>81%</td>
<td>73%</td>
<td>74%</td>
</tr>
<tr>
<td>I think the best advice right now is to make little or no change to my portfolio and plans.</td>
<td>68%</td>
<td>72%</td>
<td>71%</td>
<td>76%</td>
<td>72%</td>
</tr>
<tr>
<td>I am more worried than ever about my long-term financial security right now.</td>
<td>49%</td>
<td>64%</td>
<td>57%</td>
<td>58%</td>
<td>57%</td>
</tr>
<tr>
<td>Investing and retirement planning as we know it will not be the same again after the COVID-19 pandemic.</td>
<td>52%</td>
<td>61%</td>
<td>52%</td>
<td>48%</td>
<td>53%</td>
</tr>
<tr>
<td>I have communicated with my advisor and/or other financial professionals more than normal as a result of COVID-19.</td>
<td>22%</td>
<td>48%</td>
<td>54%</td>
<td>39%</td>
<td>39%</td>
</tr>
</tbody>
</table>

**Analyst Note:** Responses reflect those who either agree or strongly agree with each statement. The color heat map is based on how much each investor segment agreed with a given statement. Dark red indicates the segment with the lowest level of agreement for the statement; dark green indicates the segment with the highest level of agreement for the statement.

Sources: Phoenix Marketing International, Cerulli Associates
FIGURE 2
PLAN PARTICIPANTS: MOST HELPFUL RESOURCES FOR RETIREMENT PLANNING, 2020

**FIGURE 2 HIGHLIGHTS:** Nearly half (45 percent) of 401(k) participants indicate their own research is very helpful for their retirement planning, and more than one-third (40 percent) indicate one-on-one sessions with a professional advisor are very helpful.

**KEY IMPLICATIONS:** 401(k) participants tend to favor their own research; they also value the expertise and advice of a financial professional over the educational videos, articles, and group meetings offered by their employers or 401(k) providers. Although educational materials and tools can serve as a good starting point for participants who are planning for retirement, these typically represent forms of financial guidance rather than advice. Cerulli Associates believes participants can benefit from professional retirement-planning advice that is tailored to their unique circumstances, characteristics, and objectives—especially those nearing retirement with more substantial assets.

**FIGURE 3**
PLAN PARTICIPANTS WITH A PREVIOUS 401(K) ACCOUNT, 2020

**FIGURE 3 HIGHLIGHTS:** More than half (59 percent) of 401(k) participants currently have (or previously had) a 401(k) account with a former employer.

**KEY IMPLICATIONS:** Cerulli Associates believes that retirement providers and advisors can offer valuable guidance to separated employees regarding the treatment of their 401(k) plan accounts. Amid the COVID-19 outbreak, jobless claims in the United States have surged. Participants may find themselves fully vested in an employer’s 401(k) contributions if layoffs trigger a partial plan termination. For separated employees with balances less than $1,000, plan sponsors have the option to distribute funds from 401(k) accounts via check. Those with larger balances, however, need to weigh the pros and cons of performing an individual retirement account (IRA) rollover (which could provide a more consolidated view for managing assets) versus leaving retirement savings in a plan.
FIGURE 4
PARTICIPANTS’ TOP USES FOR $1,000, 2020

The most commonly cited uses for an additional $1,000 are to save for the future other than retirement (53 percent), pay down credit card debt (43 percent), or spend on leisure activities (34 percent).

KEY IMPLICATIONS:
- Retirement plan participants recognize that controlling debt—particularly high-interest debt—is a key step to achieving financial wellness, and paying off credit cards is commonly chosen as a top priority. Although fewer participants express interest in increasing their 401(k) or health savings account (HSA) contributions,* Cerulli Associates notes that, over the long run, contributing more to these tax-advantaged accounts could address participants’ top sources of financial stress—namely, paying for health care and outliving retirement assets. Although it’s unrealistic to expect that everyone can contribute up to the maximum limits prescribed by the Internal Revenue Service, advisors can help investors weigh how to most effectively use unexpected windfalls against competing long-term priorities.
- * Datapoint is not shown in figure 4.

Analyst Note: This question was asked of both active and retired 401(k) plan participants. Respondents were asked to select their top two uses if given $1,000. Other response options included “paying off medical debt,” “529 college savings account,” “health savings account (HSA),” and “other.”

Source: Cerulli Associates

TABLE 3
RETIRED PARTICIPANTS: TOP FACTORS CONSIDERED IN DECISION TO ROLL OVER TO AN IRA BY FINANCIAL ADVISOR USE, 2020

Nearly half (49 percent) of retirees report they rolled over an old 401(k) into an IRA based, in part, on the advice of a financial professional.

KEY IMPLICATIONS:
Cerulli Associates believes that retired participants, and those nearing retirement, stand to benefit from more personalized, high-touch services—including professional advice. Rollover decisions typically are spurred by life events and transitioning from employment to retirement can represent one of the more complicated, stressful life events from a financial perspective. Consequently, retirees and near-retirees frequently turn to a financial advisor to guide them through the rollover process and help them construct an appropriate retirement-income strategy. Retired participants are more likely than active participants to work with an advisor when initiating an IRA rollover.*

* Datapoint is not shown in table 3.

Analyst Note: This question was only asked of retired 401(k) plan participants who indicated they had completed an IRA rollover. Respondents were asked to select all applicable options.

Source: Cerulli Associates
FIGURE 5
ADVISORS: GREATEST CHALLENGES, 2020

New client acquisition
Compliance and regulatory responsibilities
Managing technology needs
Building multi-generational client relationships
Optimizing my portfolio construction process
Conducting ongoing investment due diligence
Hiring and managing staff
Differentiating and defining my value proposition to clients
Providing financial planning services to clients
Developing a practice succession plan

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>New client acquisition</td>
<td>56%</td>
</tr>
<tr>
<td>Compliance and regulatory responsibilities</td>
<td>40%</td>
</tr>
<tr>
<td>Managing technology needs</td>
<td>34%</td>
</tr>
<tr>
<td>Building multi-generational client relationships</td>
<td>27%</td>
</tr>
<tr>
<td>Optimizing my portfolio construction process</td>
<td>27%</td>
</tr>
<tr>
<td>Conducting ongoing investment due diligence</td>
<td>21%</td>
</tr>
<tr>
<td>Hiring and managing staff</td>
<td>21%</td>
</tr>
<tr>
<td>Differentiating and defining my value proposition to clients</td>
<td>19%</td>
</tr>
<tr>
<td>Providing financial planning services to clients</td>
<td>19%</td>
</tr>
<tr>
<td>Developing a practice succession plan</td>
<td>18%</td>
</tr>
</tbody>
</table>

FIGURE 5 HIGHLIGHTS: New client acquisition (56 percent), compliance (40 percent), and technology (34 percent) are the greatest challenges that advisors face while running their practices.

KEY IMPLICATIONS: Social-distancing measures during the COVID-19 pandemic have made it challenging for advisors to hold seminars and client appreciation events that previously provided low-pressure opportunities to meet referrals and other prospects. Asking for referrals during client meetings has become more crucial than ever. However, the pandemic also highlighted the importance of a digital marketing strategy. Although both advisors and clients have been forced to adapt to meeting digitally, many firms remain resistant to adding digital components to their marketing efforts. Time constraints and compliance restrictions are partially to blame. Smaller firms especially may not have the bandwidth available to add another dimension to their client outreach. However, even small touchpoints can lay the groundwork to building a meaningful digital presence.

FIGURE 6
REASONS FOR BEGINNING RELATIONSHIP WITH PRIMARY PROVIDER, Q2 2019

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Referral from a trusted source</td>
<td>14%</td>
</tr>
<tr>
<td>Reputation</td>
<td>11%</td>
</tr>
<tr>
<td>Someone else chose for me</td>
<td>9%</td>
</tr>
<tr>
<td>Quality of service</td>
<td>9%</td>
</tr>
<tr>
<td>Positive previous experience</td>
<td>8%</td>
</tr>
<tr>
<td>Strong investment performance</td>
<td>8%</td>
</tr>
<tr>
<td>Competitive fees</td>
<td>7%</td>
</tr>
<tr>
<td>Relationship with someone at the firm</td>
<td>7%</td>
</tr>
</tbody>
</table>

FIGURE 6 HIGHLIGHTS: Personal referrals (14 percent) remain the single most commonly cited reason for choosing a primary financial advice provider firm.

KEY IMPLICATIONS: The extreme market volatility during the first quarter of 2020 created a unique opportunity for growth-minded advisors. The equity market declines in March led to many investors questioning the skills of their advisors, or themselves, in the case of self-directed investors. Cerulli Associates’ research has found...
that within this distressing environment, those advisors who were most proactive in their communication efforts are most successful in adding to their client base. Advisors must be prepared to ramp up their outreach efforts in response to future volatility. Sharing client-approved content that is specific to the circumstances, along with express suggestions to forward it to concerned friends and family, both provides value to clients and creates a pathway of least resistance to incremental referral activity.

**FIGURE 7**

**ADVISORS' TOP PORTFOLIO OBJECTIVES OVER THE NEXT 12 MONTHS, 2020**

![Bar chart showing the percentage of advisors focusing on various portfolio objectives over the next 12 months, 2020.](chart)

- **Downside risk protection**: 6% Very focused, 9% Somewhat focused, 41% Not a focus
- **Portfolio diversification (e.g., uncorrelated asset classes)**: 55% Very focused, 36% Somewhat focused, 49% Not a focus
- **Principal protection**: 55% Very focused, 41% Somewhat focused, 48% Not a focus
- **Reduce portfolio volatility**: 11% Very focused, 41% Somewhat focused, 47% Not a focus
- **Generating income**: 39% Very focused, 36% Somewhat focused, 47% Not a focus

Analyst note: Other choices included “generating absolute return,” “tax optimization,” and “greater alpha.”

Source: Cerulli Associates

**FIGURE 7 HIGHLIGHTS:** More than half of financial advisors indicate that they are very focused on providing clients with downside risk protection and portfolio diversification over the next 12 months.

**KEY IMPLICATIONS:** The impact of the COVID-19 pandemic is laid out clearly in the four most-common portfolio objectives that advisors are very focused on: downside risk protection, portfolio diversification, principal protection, and reducing portfolio volatility. In March 2020, equity indexes were down upward of 30 percent, with fixed income markets even locking up briefly before the Federal Reserve stepped in. Furthermore, over the next few months, larger tech stocks led massive jumps in indexes. However, the specter of the pandemic still looms and investors remain wary about a market that seems disconnected with broader economic and corporate data.
**FIGURE 8**

**ADVISORS: CHANGES IN INVESTMENT ACTIVITY, 2020**

- Maintained strategic allocation (including rebalancing as appropriate) 53%
- Used opportunity to use tax-loss harvesting 50%
- Made incremental additions to depreciated asset classes (bought the dips) 38%
- Used phased investment strategy (e.g., dollar cost averaging) 31%
- Increased allocations to active managers who may outperform given current conditions 26%
- Reduced risk assets/moved money into safer investments (e.g., cash/ fixed income) 25%
- Increased individual stock allocations 21%
- Increased downside protection (e.g., derivatives/options) 18%
- Moved assets to lower-cost (passive) options 7%
- Other 2%

**Analyst Note:** Advisors were asked how client investment activity has changed since Q1 2020. Sources: Cerulli Associates, in partnership with Investments & Wealth Institute

**FIGURE 8 HIGHLIGHTS:** Half of advisors have used recent market volatility as an opportunity for tax-loss harvesting.

**KEY IMPLICATIONS:** Perhaps one of the biggest outcomes of the 2008–2009 financial crisis was the increased focus on planning and delivering holistic advice. Regulatory concerns and investor demand have forced advisors to have more long-term, goal-oriented discussions with clients around investment management. The result has been an attempt to better align investors’ perceived and actual risk tolerance, while increasing investor understanding about the fact that downturns happen. As one advisor said, “What matters the most is clients having a portfolio and then sticking with it.”

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