

Declaring Financial Independence

By Gregory DL Morris

LIVING THROUGH HISTORY makes it nearly impossible to see the forest for the trees. How many people have wondered over the past 18 months, “is this what the start of the Great Depression was like?” The collapse of big name banks and brokerage houses has been impossible to miss. But what is not so obvious is the effect on the other investment channel, the independent financial analyst. Even though the decline in asset values has been near-universal, initial reports indicate that the independent model is holding up well.

Mark Tibergian, CEO of Pershing Advisor Solutions, based in Jersey City, NJ, notes that while several major Wall Street names have been laid low by the current recession, that process has been underway for some time. “Just the other day I looked at a magazine from when I started in this business in the early 1970s, and most of the advertisers—like Kidder Peabody and E. F. Hutton—were already long gone. The growth in the advisory business has been among independents, not among the name firms.”

That trend has been accelerating, Tibergian adds, by all measures. “The transfer of assets has increased in velocity, but we are also seeing significantly more people who used to work at the big-name firms create their own independent firms.”

That is resonating with investors, says Tibergian. “At one time people wanted to run with the herd, but we have just seen that can be a herd of



Rebecca Pomeroy of Moss Adams has been a pioneering researcher in landmark studies on how independent advisors can improve their practice.

lemmings running straight over the cliff. We have also found that the only reputation that can be transferred is a bad one.” He also notes that some independent practices are now becoming as big as some of the smaller broker-dealers that serve that sector.

“The financial devastation has definitely changed the way that advisors do business,” says Elizabeth Nesvold, managing partner at Silver Lane Advisors in New York. “It used to be simple for someone to hang out a shingle for a one- or two-person oper-

The demise of big-name institutions accelerates the rise of independent advisors

ation.” She recalls that in the 1970s and 1980s advisors came out of the wirehouses and either went with a product manufacturer or out on their own as advisors. That shifted to either multi-family offices for wealth advisors, or relationship managers with open architecture.

“Now huge blemishes in the system have come to light,” says Nesvold. “So is open architecture dead? No, but it will require a much different level of service, more transparency, and clearer ownership of assets.” As a result, she expects margins to be lower, and regulation to be more costly and onerous. “Advisors are having to re-examine their business models in light of the new realities for profitability.”

Silver Lake puts together transactions where advisory firms buy, sell and merge with each other. “There is definitely a growing trend to amalgamation,” says Nesvold. But the traditional buy-sell approach has not gone away, she adds. Surprisingly, value of the franchises has not diminished much either. “There is greater demand for services, and fewer clients to go around. The new model is a firm big enough to deliver resources but small enough to have meaningful personal contact.”

The public wants choices, says Jeanne Brutman, a financial advisor based in New York. But choices mean decisions, and for that they need guidance and education. “Often people don’t really understand diversification. People thought that if they were with several different houses, or held several different funds, they were diversified.” In reality, she explains,

those different firms or funds were often investing in many of the same instruments.

Brutman also notes that the most important part of financial planning is not the planning itself but the execution. “There are lots of brochures with pretty graphs and charts that are all approved by compliance, but what clients really need is a nag to get them to implement the plan.” She says it is a lot like being a parent: you bug them because you care about them.

That takes a lot of time and effort, rare commodities at a time when profitability is tough. But the outlook is not so bad for most advisors, despite the recession. Brad Bueermann, executive vice president of FP Transitions, based in Portland, OR, concurs that valuations for advisory business have not declined in the recession. His firm helps advisors make long-term succession plans for their businesses, from rising stars within the organization, or bringing in outside leadership, or selling the business. And business has been brisk. “We are getting 40 inquiries for each listing and multiple offers,” he says. “Multiples have been the same as before the recession, and in some cases even higher. That tells me that financial advisors have evolved to be more than just stockbrokers.”

Bueermann notes that “the advisors who are gaining share have a strong planning component.” On the other side of the equation he adds that “I hear from our broker-dealer clients that they are losing people off the bottom. The marginal producers are finding the going too tough.”

One of the main drivers for all these trends, says Tibergian at Pershing, is that “if you are at a bank or a wirehouse, you are really on the sell side. You get paid by the investment. If you are independent, you are on the buy side. You get paid by the client, you have open architecture, and you have your choice of custodian. That is very compelling.”

He further explains that the trends are accelerating during this recession so much faster than during the six previous downturns through which he has lived because, quite simply, “the pain is so much worse this time around. The dot-com bubble, for example, was simply a matter of false pricing in one market sector. The current recession is across all sectors and around the world. And large firms with many moving parts have been affected more severely.”

Pershing LLC, the largest clearing firm in the world with about \$715.8 billion in assets held in custody, was founded on January 1, 1939 as Pershing & Company and boasted \$200,000 in capital. The firm’s original senior partners were Van Burger, Sr., Ed Cohan, Lou Froehlich, Dave Foster and its namesake—Warren “Jack” Pershing, the only son of celebrated WWI General of the Armies, “Black Jack” Pershing. Parent company Bank of New York Mellon, founded by Alexander Hamilton in 1784, is celebrating its 225th anniversary this year. (The Museum is housed in the former Bank of New York headquarters at 48 Wall Street.)

Moss Adams Wealth Advisors, based in Seattle, is one of the new



*Left: Elizabeth Nesvold,
managing partner at Silver Lane Advisors.*

Right: Stephen Horan of the CFA Institute.

firms formed by advisors out of a big-name firm, but with a major twist: Moss Adams is one of the leading consulting firms to the financial services sector, and Rebecca Pomeroy was a pioneering researcher in landmark studies on how advisors, especially independent advisors, could improve their practice. The parent company published its annual “Compensation and Staffing Study” in September.

In July 2008 Pomeroy established Moss Adams Wealth Advisors as an independent wealth management practice affiliated with the parent firm. Her vision and her ambition could not have been clearer, and her timing could not have been worse. “We had \$800 million in assets under management at inception, and \$700 million by the end of year. Whether advisors were strategic or tactical there was no place to be safe anywhere across all research platforms. I cannot imagine a downturn harder than this one,” she says.

Proportionally, a loss of 12.5% was a shining accomplishment in a market that fell by half and at a time when the quip on the Street was “down 20% is the new flat.” But still, \$100 million dollars in wealth is not like losing change in the couch. “We are back to about \$750 million now,”

says Pomeroy, “but we did have to have some reduction in staff.”

Most importantly her faith is not shaken. “Some advisors will make changes, but the structure of the independent model is not broken. Clients’ needs have changed, but the fundamentals of the business and the productivity metrics have not changed.” Pomeroy is still worried about excess, but now it’s excessive regulation and excessive fear in the market.

There is also a concern that the basic pricing mechanism in the business may be flawed. “Getting paid as a percentage of assets under management means that in rising markets, when assets grow fastest, advisors get paid more even though their services may be needed less,” Pomeroy says. “When markets fall and clients most need guidance, assets decline and advisors’ pay goes down. The challenge is to align the compensation structure with the true service to the client.”

Another measure confirms the observations that the recession is accelerating the influx of both advisors and assets to the independent wealth-management channel: the number of people with certification in the field. The Chartered Financial Analyst designation, administered by

the CFA Institute in Charlottesville, VA, is one of the oldest and most-respected accreditations an individual advisor can hold.

Stephen M. Horan, head of professional education content and private wealth for the institute, notes that the number of advisors registering for the CFA examination in the most recent fiscal year was higher than ever. “That is counter-cyclical, but people tend to defer the decision to go out on their own or to seek certification until there is some event or milestone, and this recession is more severe than previous ones. Advisors are questioning how to position themselves, and how to respond to clients and prospects who are asking ‘how do I know you’re not Bernie Madoff?’”

Training and certification are one way. But Horan acknowledges that there is still “an alphabet soup problem. The public is still not clear on which designations mean what.” Before the bust, clients were most interested in yield, Horan explains. “Alpha” was on everyone’s lips. “Now clients are more conservative, but there is more to wealth preservation than risk premiums and bond spreads.”

Horan says the fundamental change he is observing in the advisory business

Left: Jeanne Brutman,
a financial advisor based in New York.

Right: Mark Tibergian,
CEO of Pershing Advisor Solutions.



is that some advisors are now viewing clients' objectives in life—house, college education, travel, retirement—not as goals but as a string of liabilities to be funded. They are thinking like pension-plan managers who have certain financial obligations to meet at certain times in the future and deploy assets to meet those obligations.” The term is to “defease,” which means allocate today against known future liabilities.

In January of 1947, four financial analyst societies—Boston Security Analysts Society, Investment Analysts Club of Chicago, New York Society of Security Analysts and Financial Analysts of Philadelphia—joined forces to form the National Federation of Financial Analyst Societies. The name was later shortened to the Financial Analysts Federation, or FAF, and in 1990, the FAF merged with the Institute of Chartered Financial Analysts, or ICFA, to form AIMR, now CFA Institute.

In 1945, two years before the foundation of the NFFAS, the first issue of *The Analyst Journal* was published. This publication would eventually become what is known today as the *Financial Analysts Journal*. In its inaugural issue, Benjamin Graham described “the advantages of a rating system” for financial analysts: “The

analyst who qualifies for the rating,” wrote Graham, “will have the obvious advantages of prestige, improved ability to get a job, and the chance for higher pay. In addition, he is likely to develop a more professional attitude towards his work and a keener interest in maintaining and advancing the standards of his calling.”

Other observers continue to offer constructive criticism of the independent advisory channel. One sea change was marked by Jim C. Otter's book *High Expectations & False Dreams: One Hundred Years of History Applied to Retirement Planning*, published in 2001 after the dot-com bust. Until then it was received wisdom in financial planning that as an individual aged the safe play was to increase the percentage of assets in fixed income.

Otar put the data to the idea that “the math of accumulation and the math of distribution are completely different. During accumulation the problem is volatility,” says Otter. “But once you flip the switch into distribution, the problem is not volatility, it is sequence. In the first four years after accumulation ends, one very bad year, down 10% or more, or two medium bad years, down 5%, or four years at 0%, can cut the life of an accumu-

lated portfolio in half, from 30 years to 16 or 17 years,” Otter explains. That is a serious problem, because with demographic trends showing life expectancies closing in on 90, 30 years of retirement is not just possible but likely.

Otar says few people believed him when he published his original work in 2001. “But I have had a few people thank me for helping them plan. I always answer that I am not giving investment advice, just looking at financial history.” Now that more people are willing to listen, Otter is coming out with a new book, *Unveiling the Retirement Myth: Advanced Retirement Planning Based on Market History*, which is due out in October. **EH**

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