# MONEY management executive

The Premier News Source for Asset Management Leaders

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SPECIAL REPORT: STATE OF ASSET MANAGEMENT

## OPERATIONS: New tech, fee wars drive disruption

By Rebecca Stropoli

An escalating race to zero in fund fees and improvements in data and analytics are among the leading issues impacting asset management companies today.

*Money Management Executive* discussed these trends and more with various industry leaders who are shaping the space.

Josh Vail, president, 361 Capital

Savina Rizova, co-head of research, Dimensional

"Data pinpoint the advisors who are interacting with your content," says 361 Capital President Josh Vail.

"The relationship between asset managers and advisors is evolving, with advisors rightly expecting managers to provide guidance about navigating markets, not just offer product," he adds.

Dimensional Fund Advisors' co-head of research, Savina Rizova, says demand for income-based retirement savings vehicles is growing.

It's "a trend we believe will continue to impact the asset management industry," Rizova says.

For more on what Vail, Rizova and four other executives from across the industry are focused on, read our special report.

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## TECHNOLOGY: Robo competition for Vanguard?

By Sean Allocca

Vanguard's robo advisor may soon have competition at the top.

The firm's Personal Advisor Services still claims the largest portion of digital client assets, topping $106 billion in AUM last year. But competing offerings from discount brokerages — such as Schwab's Intelligent Portfolio — may soon vie for the crown, according to the latest study of digital platforms by Aite Group.

"Our position is that online brokers will be the dominant factor moving forward," says Aite Group senior analyst Alois Pirker, citing a portion of the $6 trillion on brokerage platforms expected to transition to fee-based advice. In fact, discount brokerages are expected to control the plurality of robo advisory assets by 2023 — cornering almost half of all digital as-

**ROBO, on page 11**

## PRODUCTS: Hedge fund-style product from Wealthfront lags

By Julie Verhage and Luke Kawa

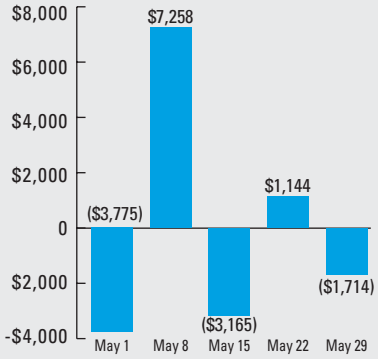
Wealthfront is known for doing the most boring type of investing possible — sticking clients' money in mutual funds and ETFs and taking a small fee.

But last year it launched a new product that departed from that model. The Wealthfront Risk Parity Fund, announced in early 2018, was styled after the esoteric calculations of famous hedge fund manager Ray Dalio. Since then, the fund has amassed more than $860 million in assets under management according to Bloomberg data, and has become a lightning rod for controversy.

Wealthfront sees risk parity, a strategy that aims to diversify portfolios in order to protect from price swings in any one type of asset, as a way to compliment the holdings of its biggest customers. But critics see a volatile prod-

**WEALTHFRONT, on page 10**

**Outflows from long-term mutual funds were $1.71B for the week ending May 29 (millions)**

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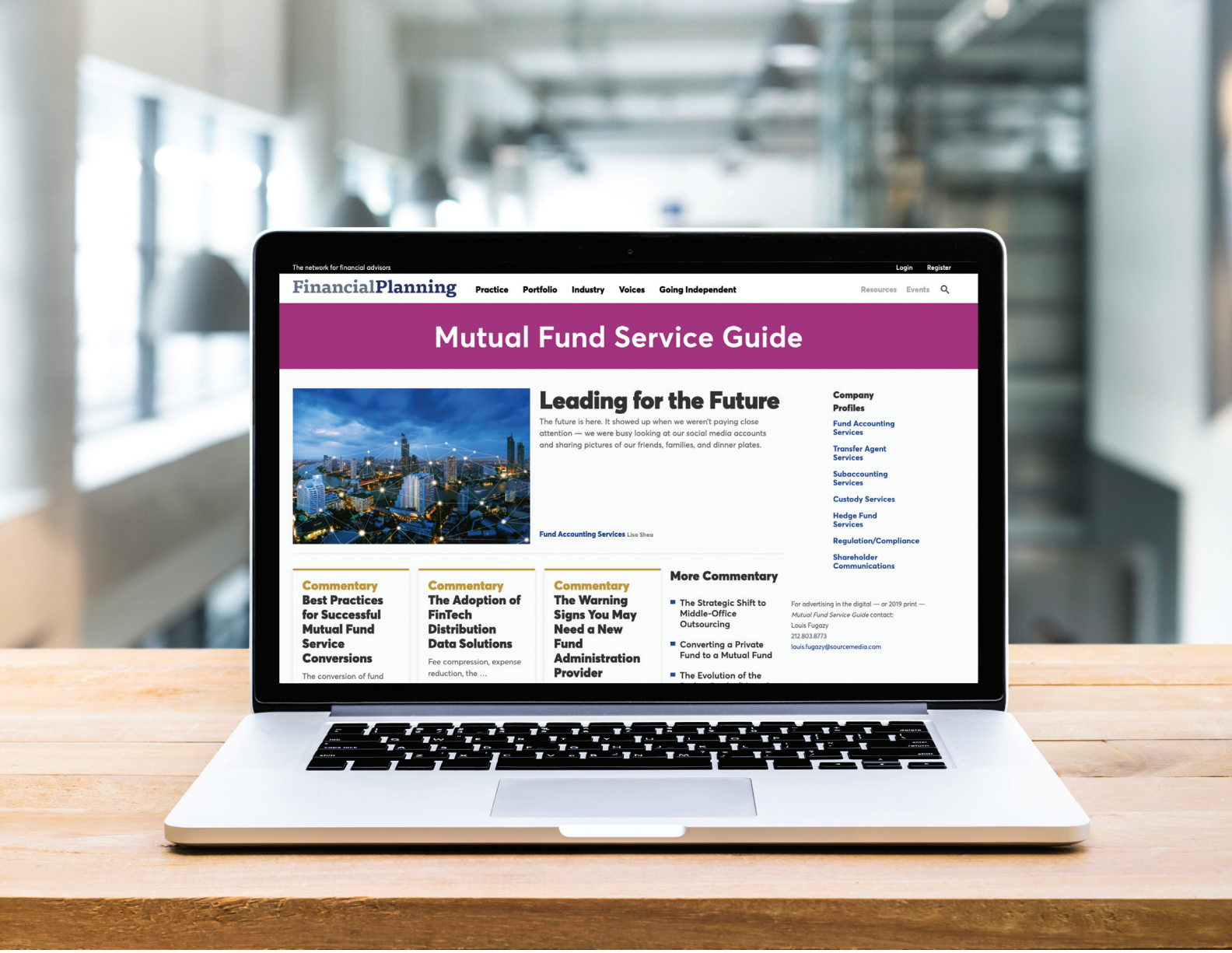


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Money Management Executive

## INDUSTRY HIGHLIGHTS

### FIDELITY MAKES TARGET-DATE PRICE REDUCTIONS

Fidelity Investments has made a 14% price reduction on entry-level share classes for its Fidelity Freedom Index Funds and Fidelity Institutional Asset Management Index Target Date Commingled Pools, according to the firm.

Following the change, 21 of the 22 Fidelity index funds will carry net expense ratios lower than similar Vanguard products, saving shareholders an estimated $3.2 million annually, the firm said.

"At Fidelity, we have a long history of providing investors with a wide array of high-quality products at a great value to help them meet their investment goals," said Eric Kaplan, Fidelity's head of target-date products. "These target-date index fund expense reductions build on that legacy, providing our tens of millions of customers — individual investors, workplace retirement plan sponsors and participants, and financial advisors — an even more compelling value proposition."

### LPL REDUCES ETF PRICING ON RIA PLATFORMS

LPL Financial clients will pay 45% less on ETF transaction charges from various providers, according to the firm.

Transaction charges associated with ETFs offered on LPL's strategic asset management and strategic wealth management platforms, designed specifically for advisors on the firm's corporate, hybrid or RIA-only platforms, will drop to $4.95 from $9 for State Street, Invesco and WisdomTree, according to the firm.

"The firm remains committed to leveraging our scale to invest in advisors' businesses with price reductions and new capabilities," said Rob Pettman, LPL Financial's executive vice president of products and platforms. "ETFs are another step in the journey to expand our breadth of solutions and help advisors remain competitive in the marketplace."

### NICSA ADDS COMMITTEES ON ALTS, SMAs

In an effort to expand its focus on product development and distribution, industry trade association NICSA announced the launch of new committees focused on alternatives and separately managed accounts.

The group's alternatives committee will focus on industry standardization and best practices between product providers, distributors and service firms, and will advocate for streamlining policies associated with service and distribution, according to NICSA.

The new committee will be chaired by John Corbisero, executive director and head of traditional and alternative investment operations at Morgan Stanley, and Peter Tenggren, director of strategic product management and asset serving capabilities at BNY Mellon. The SMA working group will operate under the association's existing product and distribution committee, which is composed of senior executives from 20 investment firms. Scott Brady, who leads U.S. product development and strategy at Columbia Threadneedle, chairs the NICSA product and distribution committee.

**ETF estimated net issuance** ($ millions)

| | 5/29/2019 | 5/22/2019 | 5/15/2019 | 5/8/2019 | 5/1/2019 |
|---|---|---|---|---|---|
| **Equity** | -3,022 | 5,504 | -9,477 | -8,613 | 5,539 |
| Domestic | -2,377 | 6,943 | -7,048 | -9,069 | 4,394 |
| World | -645 | -1,439 | -2,429 | 456 | 1,144 |
| **Hybrid** | 64 | 3 | 76 | 74 | 134 |
| Bond | 1,807 | 1,006 | 1,864 | -268 | 1,042 |
| Taxable | 1,580 | 860 | 1,810 | -593 | 626 |
| Municipal | 226 | 146 | 54 | 325 | 416 |
| Commodity | 157 | 178 | -708 | -745 | -192 |
| Total | -993 | 6,690 | -8,245 | -9,553 | 6,523 |

Source: Investment Company Institute

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# NEWS SCAN

## PRODUCTS

### NEW FRONTIER LAUNCHES 6 GLOBAL MULTI-ASSET ETF INDICES

New Frontier has launched six indices to reflect the systematic equity risk levels along the Michaud Efficient Frontier, according to the firm. Each is composed of 20 to 30 diversified, low-cost ETFs that include stock/bond ratios of 20/80, 40/60, 60/40, 75/25, 90/10 and 100/0, the firm said. The indices are made up of equity, commodity and fixed-income ETFs from iShares, SPDR and Vanguard, according to the firm.

### QUADRATIC ETF TO HEDGE AGAINST AN INFLATION INCREASE

Quadratic Capital Management launched a new ETF aiming at profiting from an increase in interest rate volatility and steepening yield curve, according to the firm.

The Quadratic Interest Rate Volatility and Inflation Hedge ETF (IVOL), which has an expense ratio of 0.99%, seeks to hedge against an inflation increase and profit from an increase in interest rate volatility, according to the firm. Nancy Davis, managing partner and chief investment officer of Quadratic, will manage the fund.

### CALAMOS ANNOUNCES SMALL-CAP GROWTH FUND

Following its acquisition of Timpani Capital Management, a boutique small- and mid-cap investment manager, Calamos Investments says it has completed revisions to its small-cap growth strategy.

The newly named Calamos Timpani Small Cap Growth Fund, which has a minimum investment requirement of $100,000, will maintain its investment team and eight-year track record alongside the Calamos Timpani Small Cap Growth Strategy, a separately managed account with an 11-year track record.

### HARTFORD LAUNCHES ITS FIRST MULTIFACTOR MUTUAL FUNDS

Hartford Funds announced the launch of its first two multifactor mutual funds: the Hartford Multifactor International Fund (HMIVX) and the Hartford Multifactor Large Cap Value Fund (HMLVX).

HMIVX, which tracks the Hartford Risk-Optimized Multifactor Developed Markets (ex-U.S.) Index (LRODMX), aims to provide exposure to developed markets in Europe, Canada and the Pacific Region.

HMLVX tracks the Hartford Multifactor Large Cap Value Index (HMLCVX), which seeks to outperform traditional cap-weighted, value-oriented U.S. equity market indices and active U.S. equity market strategies, while reducing volatility over a complete market cycle, the firm said.

### SYMMETRY PARTNERS UNVEILS MUTUAL FUND FAMILY

Symmetry Partners has completed the launch of its Panoramic Mutual Funds, a suite of eight open-end funds, according to the firm.

The suite, built and advised by Symmetry, includes U.S. equity, international, global, tax-managed, fixed income, muni and alternatives. They will be managed by institutional managers including Dimensional Fund Advisors, AQR Capital, Vanguard, JP Morgan Asset Management and BlackRock.

"The Panoramic Funds are backed by Symmetry's 25 years of experience and commitment to helping investors achieve their most important goals," said Patrick Sweeny, principal and co-founder of Symmetry Partners. "We do this by drawing on extensive academic research — and Symmetry's own — to engineer what we believe to be exceptional investment solutions."

### VANGUARD LAUNCHES ITS FIRST ACTIVE GLOBAL ESG STOCK FUND

Vanguard announced the launch of the Vanguard Global ESG Select Stock Fund, the first actively managed offering in the firm's lineup of ESG funds.

The open-end fund is available in two share classes, Admiral Shares (VESGX) and Investor Shares (VEIGX), with estimated expense ratios at 0.45% and 0.55%, respectively.

"Vanguard's new Global ESG Select Stock Fund is taking a distinctive approach to ESG investing, seeking long-term outperformance through the selection of companies that integrate leading ESG practices into their corporate strategies," said Matthew Brancato, head of Vanguard's portfolio review department.

## ARRIVALS

### ARTIVEST APPOINTS CHIEF MARKETING OFFICER

Artivest has appointed the former chief marketing and communications officer at Willis Towers Watson, Paul Nobile, to its newly created chief marketing officer position, according to the firm.

Based in New York, Nobile will oversee the firm's marketing and communications strategy, and execution processes, the firm said. He will report to James Waldinger, founder and CEO of Artivest.

Paul Nobile

Prior to Willis Towers Watson, Nobile was chief marketing officer and managing director at BNY Mellon, senior vice president at Eaton Vance, and managing director and head of global brand marketing at Barclays Global Investors, now BlackRock, where he helped launch and build its iShares brand, Artivest said.

### CALAMOS HIRES CHIEF INVESTMENT OFFICER

Calamos Wealth Management hired J. Reed Murphy, the former president and chief investment officer at TC Wealth Partners, as CIO, according to the firm.

Murphy will oversee all aspects of Calamos' investment platform, including strategy and implementation of new products, as well as communication with clients and business partners, the firm said.

"We feel fortunate to have acquired [Murphy] who, I feel, is one of the most experienced investment professionals serving wealth management clients in the country," said Jim Baka, president of Calamos Wealth Management, adding that his "talents for communicating complex issues, along with his natural leadership style, are welcomed contributions as we enter into the next phase of our firm's growth."

Michael Kassab, who previously held the position of CIO, is now moving to Calamos Investments as its chief market strategist. MME

*News Scan by Andrew Shilling*

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*Symmetry Partners Director of Investment Product Strategy & Communications Casey Dylan*

# The tech evolution

Several significant long-term trends have driven the rapidly changing asset management industry.

Most notably, new technologies are disrupting the industry and have contributed to accelerated fee and margin compressions.

The fintech revolution is forcing the financial services industry to evolve rapidly.

Historically, financial institutions have leveraged in-house teams and third parties to provide investor services.

That period is clearly behind us.

Now, major financial players are investing millions of dollars in order to vertically integrate those services and reduce the cost and friction associated with delivery, while leveraging technology to achieve scale and efficiencies.

The acceleration of the tech evolution has had an impact on the competitive landscape and customer expectations, which has accelerated the fee and margin compression the industry is clearly undergoing.

While this is beneficial for investors, it is challenging for providers, as both are increasingly seeking low-cost solutions.

This pressure has led to a shift in product set, with lower-cost ETF structures taking the main stage.

Quantitative, data-driven investment strategies, such as passive, index-based factor investment approaches are also the beneficiaries.

Total assets in these strategies have now reached parity with that of active management, and we expect them to continue to dominate flows over the long run.

At the same time, fee compression has led many firms to find ways to increase the value they provide beyond investments, including education and practice management.

The confluence of these trends has resulted in greater manager consolidation, as smaller active managers find it tough to compete with the race to zero in fees, the costs of providing additional value and the level of technology investment.

*361 Capital President Josh Vail*

# Improving communication

Boutique asset managers face a daunting distribution dilemma: how do smaller sales teams best approach a network of advisors?

Data and analytics make the task doable, and results in more profound conversations with advisors. The use of data analytics is not just a trend affecting large firms, but also has the potential to affect boutique asset managers and specialist distribution teams to an even greater extent.

With limited resources, each salesperson must identify only the 200 to 1,000 advisors with whom they are most likely to build a meaningful relationship.

Data pinpoint the advisors who are interacting with your content. Additionally, the relationship between asset managers and advisors is evolving, with advisors rightly expecting managers to provide guidance about navigating markets, not just offer products.

Data help build that relationship. By tracking the usage and consumption of our content, we garner insights into what is top-of -mind to the advisor community. We can then dedicate more energy to writing about and discussing those issues and engaging further with clients and potential ones.

Analytics also improve the conversations our sales team have with advisors.

By identifying what information the advisor consumes, distribution members can dive into any questions the advisor may have.

The proof is in the numbers: Last year, more than 50% of our new sales came via leads from someone accessing our thought leadership. Data and analytics have made those resources — and the follow-up conversations — more relevant.

*Robo Global Head of Capital Markets and Sales Chris Buck*

# Beyond the race to zero

Large custodians may discount ETF management fees to attract more clients.

But smart investors look beyond the headline of management fees by considering a multitude of other factors — SEC lending revenue, tracking difference, bid/offer spread cost and the risk-adjusted returns of comparable funds. As investors begin to appreciate these other considerations to zero-fee funds, here are three resulting impacts on asset management operations:

1. Boutique asset managers could experience a resurgence. Boutiques are not trying to be everything for everybody, like many of these larger firms. They're trying to provide great value to those who want it. Asset management continues to see large-scale players partner with boutique investment firms that focus on a particular strategy or competency. Managers caught in the middle will likely change product offerings and morph active strategies into private equity offerings or non-transparent active ETFs.

2. More asset managers will continue to discount ETF pricing. This will help attract new clients and/or there will be an attempt to make up the revenue loss with other ancillary products such as proprietary money market funds or advisory fees on digital advice. Given the volatility in markets and behavior of investors to buy high and sell low, there are unprecedented levels of cash in accounts that could increase net interest income for sponsors with proprietary money market funds.

3. Publicly traded asset managers will continue to restructure their labor force and increase productivity by using robotic process automation. RPA is based on the notion of software robots or AI workers increasing efficiency in servicing clients.

This is not a bullish case for employees and client service professionals. The lower fees will probably result in more layoffs for larger asset managers, which could impact the investors' experience and stifle innovation.

The race to zero beta narrative is more important to the large asset management executives than to investors. There is no doubt investors can benefit from lower fees, but they will also choose to pay more for innovative offerings.

*Procure Holdings President Bob Tull*

# Beating the benchmark?

A strategy called ensemble active management uses ensemble mathematics to construct active portfolios where returns are predicted, with a high probability of success, to exceed the benchmark.

The technology has been in use since 1979 in chip design and entertainment, and is moving to investment management.

The technology has three core components: big data collection and analytics, predictive algorithms and machine learning. These tools are being employed by active managers to support their security selection process and release them of their beta anchors. EAM delivers alpha portfolios with acceptable risk tolerances and the mitigation of toxic portfolio tails.

Each manager begins their process by defining the benchmark and selecting competitive funds within the same investment benchmark category. Within two weeks, the manager receives the EAM portfolio of expected excess benchmark returns. The longer the EAM technology remains stable, the greater the predictive capabilities through machine learning, and the greater chance of capturing excess returns.

EAM is the counterpunch to the increase in passive management. It will reinvigorate the discussion of active verses passive management by providing a technology solution for active managers.

EAM will help reduce asset fee compression, as active managers will be able to deliver consistent excess performance. This is a process I believe will impact active management just as ETFs did for passive investments.

**SPECIAL REPORT CONTINUED on page 9**

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*Seismic Managing Director of Financial Services William Finnegan*

# Managing new expectations

There has been a huge movement toward the so-called consumerization of the asset management business over the past decade, as new approaches are breaking down barriers, lowering fees and making investing more accessible to a new generation of investors.

Coincident with this has been a shift in expectations for the investing experience, which has major implications that all asset managers and their sales and marketing teams must grapple with.

The current processes used in asset management for generating marketing materials and reaching out to clients and prospects are inefficient and ineffective.

Research confirms this: SiriusDecisions found that roughly 70% percent of marketing collateral goes unused, while a Gatepoint survey reported that 67% of business decision-makers said personalizing content is the key to improving the impact on sales.

New technologies known as sales enablement, which allow for highly customizable, compliant materials, produced in real time and delivered digitally, are emerging to address this challenge for the asset management industry — and they're arriving at the right time.

Asset managers should take note of a recent study from EY, which found that most investors today are looking for a combination of digital access and human interaction.

This is a trend that's not only upending asset management but wealth management as well.

Asset managers who build their marketing approaches to leverage new technologies in ways that allow them to better partner with advisors and wealth managers — who are themselves going through their own period of upheaval — will be better positioned for long-term success.

The future of asset management requires the industry to look at the present state of the retail sector.

Embrace technology, learn about your customer —or risk losing them to someone who does.

*Dimensional Fund Advisors Co-Head of Research Savina Rizova*

# Developing retirement tools

The increasing prevalence of defined-contribution plans as primary retirement savings vehicles — and the corresponding burden on participants in managing their investments — reinforces the need for continued advancements to improve retirement outcomes. Retirement-focused investment solutions, more readily accessible information and comprehensive planning tools that allow participants to better manage the transition from accumulation to decumulation are all areas we believe have seen significant progress in recent years.

People saving for retirement now have access to investment solutions designed to effectively manage market risk, inflation risk and interest rate risk.

There has also been emphasis on providing more meaningful information on projected income in retirement.

A statement that translates a participant's balance into monthly annuity income is a welcome improvement.

But how can a participant plan effectively without information about the uncertainty of such an estimate, and how their current investments are managing the relevant risks?

Demand for income-focused retirement solutions, as well as for reporting and planning tools, is a trend we believe will continue to impact the asset management industry.

We believe it's critical for asset managers to work alongside plan sponsors and regulators to address that demand and help improve retirement outcomes. MME

**WEALTHFRONT**
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uct that has underperformed benchmarks, contains difficult-to-understand costs, and a launch that automatically opted users into the fund, rather than allowing them to join of their own volition.

The tumult surrounding Wealthfront's risk parity fund comes at a pivotal time for the company, and for robo advisors in general. Established competitors like Fidelity Investments and Charles Schwab are muscling their way into startups' turf with their own low-fee digital investing products. The heightened competition likely helped send Wealthfront's valuation down by almost a third, to $500 million, in its latest funding round announced early last year.

One obvious solution would be to try to eke out a profit with more lucrative product offerings like proprietary funds, which could allow it to fork over less money to ETF makers like Vanguard. But if it goes that route, Wealthfront could wind up looking more like a regular Wall Street firm — in other words, exactly the thing it was created not to be.

### LINGERING COSTS

Co-founded in 2008 by venture capitalist Andy Rachleff, now CEO, Wealthfront has pitched itself to millennial consumers as an easy place to park cash, with a beautiful digital interface and annual fees of only 0.25%, or less. The concept was a hit with investors, garnering roughly $200 million in funding, as well as with customers. It has more than $10 billion under management. Then, last year, the company became one of the first robo advisors to launch a proprietary mutual fund, with the creation of the risk parity product, and almost immediately drew user outrage.

The idea behind risk parity was popularized by Dalio and his hedge fund Bridgewater, and aims to spread risk equally across different types of assets, based on the historical and expected price swings of stocks, bonds and commodities. The portfolio's balance is supposed to reduce volatility and provide smoother returns. When Wealthfront created its own version of the fund, it wrote in a blog post: "Our research PhDs and engineers spent the past year effectively replicating Bridgewater's risk parity strategy," with the end-result of a product that "aims to increase your risk-adjusted returns in a wide range of market environments."

But users balked at the management fees, which were 0.5% of the account's value each year — a shock to customers used to being charged half that. Two months later, Wealthfront backtracked, lowering fees for the risk parity product to 0.25%.

That management fee is today the lowest in the industry for a risk parity strategy, according to the company. Similar products from hedge funds and larger investment firms often charge significantly more. But questions about the fund's total costs linger. Because of its complex structure, it includes holdings like total-return swaps, which incur fees of their own. Most funds include some costs of this kind, though it's often difficult to figure out how much. Depending on the exact makeup of the fund and the fees associated with those products, which isn't public, this could bring the cost higher for Wealthfront customers.

The actual range of possible fees users are paying could vary. Given the swaps and bonds in the portfolio, Cullen Roche, an asset manager based in California, estimated the all-inclusive range to be anywhere from 0.5% to 2%. "My guess is that it's high," Roche said.

Wealthfront did not respond to requests for comment on this story.

### PERFORMANCE FALTERS

Regulatory filings indicate that customers were likely paying closer to 1% in total fees, rather than 0.25%, for a large chunk of the fund's holdings for part of last year. According to the company's disclosures around risk parity, Wealthfront paid a spread of 55 to 65 basis points above Libor for its bond holdings, or about 0.55% to 0.65% beyond the international interest rate benchmark. Those fees would be taken out on top of the 0.25% management fee.

For Wealthfront customers, there were a few other reasons to be irked over the new fund. The company automatically put up to 20% of the holdings of accounts worth more than $100,000 into the product, meaning users had to specifically log in to the app to decline if they weren't interested. And just a few months out of the gate, its performance faltered.

The fund launched in late February of last year, but performance data is available starting in late January. From Jan. 29 through mid-May 2018, it was down more than 9%, prompting more early criticism. Wealthfront has published a blog post addressing the issue, which it updates from time to time titled, "What explains the recent performance of Risk Parity?" The fund, Wealthfront explained, has a higher allowance for volatility than its peers, causing swings in either direction to be larger than those of similar portfolios.

So far this year, the performance has been better as the market has climbed. The fund has returned about 11%, compared to roughly 9% for an S&P risk parity index. But it's still down about 5% since its inception.

In general, robo advisors "are pushing the rest of Wall Street in the right direction" with their low fees, increased transparency and digital tools, says asset manager Roche. But as startups dabble in more traditional Wall Street products, they run the risk of eroding some of those advantages. When it comes to the total fees in the risk parity fund, says Roche: "Because we don't have that transparency now, I think you'd be crazy not to opt out." — *Bloomberg News* MME

**The idea behind risk parity was popularized by Ray Dalio and his hedge fund Bridgewater, and aims to spread risk equally across different types of assets, based on the historical and expected price swings of stocks, bonds and commodities.**

**Robo**
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sets, according to the study.

On the other hand, product managers like Vanguard are expected to account for roughly a third of all digital assets, setting up a head-to-head match-up between two of the industry's most dominant digital players.

Low-cost investing pioneer Schwab now manages more than $3.5 trillion in client assets.

The firm began charging clients flat fees for its Intelligent Portfolio robo advisor, catering to a younger consumer base that prefers to pay for products on an ongoing basis. Digital clients pay $300 for a financial plan and $30 a month instead of traditional AUM fees.

Schwab currently manages $33 billion in assets through the Intelligent Portfolio platform, according to the study.

"The online brokerages are some of the fastest-growing franchises in the industry and has been for the past decade," Pirker says. "There is a lot of pent up demand for portfolios."

### ROBO USE GROWING

Nearly 60% of Americans expect to use a robo advisor by 2025, according to research by Charles Schwab. Forty-five percent of Americans think robo advisors will have the greatest impact on financial services — more than other forms of technology including cryptocurrency, blockchain and AI.

"Advice is not a 'one size fits all' proposition," a Vanguard spokesman says. "The spectrum of advice offers and models will continue to evolve and improve — all of which will benefit investors. Ultimately, advice can help investors achieve better outcomes, and the more access to it, the better."

In total, assets managed on digital platforms are expected to soar to $1.26 trillion by 2023.

The shift toward fee-based advice and an anticipated fiduciary standard will likely further drive assets onto digital platforms, Pirker says.

"When you look at the composition of any advisor, there is a certain share of the accounts that are just too small to be profitable," he says. "Even at the largest and most profitable firms."

Schwab grew digital assets by 23% year-over-year, according to the firm.

"We are confident in our growth in robo assets, but any player broadening access to planning and advice to more people is a good thing," says a Schwab spokesman in an email.

With a vote upcoming on the SEC's Regulation Best Interest proposal, advisors may have to make adjustments to how they're serving clients with fewer assets, Pirker says. "Something will happen with a fiduciary standard, and digital platforms will have a solid strategic position to be able to handle those accounts in a different manner," Pirker says. "It might not be tomorrow, but it's the direction things are heading."

Mutual fund companies, including Vanguard and BlackRock held the most assets, with 42.1% of total digital AUM last year, according to the study. Discount brokerages, such as Schwab and E-Trade, held 34.6%.

Advice startups including Betterment and Wealthfront accounted for just 15.9%.

Ominously for the robos, all four of the market exits cited in the report were startups.

### ACHIEVING GROWTH

"Moving forward, it will become even more difficult for independent robo advisors to achieve profitable growth, considering the very high cost of customer acquisition," says Roi Tavor, CEO of the research firm Nummo, which completed a study this year of more than 300 online investment portfolios.

However, many independent robos have shifted toward working with advisory firms, where a large book of business is already on hand.

Due to valuation considerations and the fact that all major incumbents already or are planning to offer digital financial advice, the road to continued growth for many independent robos seems steep, Tavor says.

"An IPO might be an option," he says. "However, asset bases would have to increase substantially first."

**"Moving forward, it will become even more difficult for independent robo advisors to achieve profitable growth, considering the very high cost of customer acquisition."**

Roi Tavor, CEO of research firm Nummo

While industry projections differ on the exact amount of digital assets coming to robos, the need for digital advice will likely continue to drive clients toward more efficient and cost-effective options, he says.

The incumbent players will likely continue to grab assets and dominate the online advice landscapes, according to the study.

JP Morgan rolled out You Invest to DIY clients in August, and plans to add robo advised portfolios later this year, according to Bloomberg.

### 'SHIFT FROM HUMAN TO DIGITAL'

Goldman Sachs recently bought United Capital and its FinLife technology, with an eye toward attracting mass affluent consumers.

"Given the continuous cost pressure financial institutions experience, a further shift from human to digital advice must be expected," says Tavor. "And with the rapid transfer of wealth from baby boomers to the next generation, [AUM projections] could be significantly higher." MME

# Supplemental trading: Expanding the reach of buy-side traders

By Aaron Hantman

The asset management industry is undergoing a period of significant and radical change, largely driven by regulation, advancements in trading technology and the impact of passive.

As if these challenges weren't enough, equity commissions are down 45% since 2009. In no uncertain terms, players on both sides of the fence are being forced to rethink past practices.

For buy-side equity traders, this means carefully managing costs and counterparty relationships, as well as mapping out a plan to acquire research while seeking best execution. For the sell-side, this likely leads to providing less research, and in fewer sectors, focusing on select clients and managing with an eye toward profitability versus market share.

The days of being all things to all people are over.

While these changes will be disruptive, they will also create new opportunities. For example, at our firm, Tourmaline Partners, we are seeing increased demand from investment managers who have their own traders or trading teams, as they seek to supplement their resources. It is clear that this demand derives from the aforementioned changes.

This new construct, supplemental trading, is simply a byproduct of outsourced trading, a practice that had its genesis with emerging managers, typically hedge funds at launch. Our nascent growth with more-traditional investment managers has made clear that, up until now, much of this community was unaware that supplemental trading existed and was an available resource. So here we offer a primer on what an investment manager should know about supplemental trading.

A supplemental trading solution is one that allows a buy-side trader to engage experts for some of their execution, as opposed to outsourcing the entire trading function. This can be used to both address existing challenges and accomplish specific goals. A buy-side trader would use a supplemental trading solution to:

- Improve access to liquidity when trading small caps or difficult-to-trade names
- Trade developed, emerging or restricted international markets
  - Avoid having a lone overseas trader or night trader.
  - Avoid leaving unsupervised orders on a sell-side desk overnight.
- Gain anonymity
  - On all trading
  - When building or exiting a large position or a sensitive name
- Reach specific brokers that don't cover you, in order to:
  - Pay for research, meetings or calls, in lieu of (or to complement) a commission sharing arrangement
  - Access liquidity that you don't see.
- Access options trading expertise/implement hedging strategies
- Address bandwidth / capacity issues
  - On busy days or when traders are on vacation
  - Over the long term (to avoid adding staff)

Most investment managers have cut their broker lists to be more efficient and to reduce expenses. While a sensible strategy, it creates challenges when traders need to access specific brokers opportunistically and infrequently.

We also note that rapid growth and advancements in trading technologies have created a fragmented liquidity heat map. This has made it necessary for buy-side traders to devote increasingly precious time and resources on evaluating new algorithms, dark pools and trading venues in order to remain competitive. Leaning on experts can help to ameliorate these challenges.

As demand for supplemental trading grows, more brokers are entering the space and existing players will likely commit additional resources. This growth will lead to a number of different types of offerings and will require a fair amount of due diligence from investment managers who are seeking differentiated trading expertise.

At Tourmaline, our specific focus is on providing investment managers with a buy-side solution that expands a trader's reach to the sell-side, improves execution performance and reduces costs. In doing so, we also provide brokers with a path to order flow and revenue from investment managers with whom they no longer work or prefer not to set up and service directly.

**"Most investment managers have cut their broker lists to be more efficient and to reduce expenses."**

**Tourmaline CEO Aaron Hantman**

The good news, so far, is that clients are seeing results. In the 2018 report "Outsourced Trading: Helping the Buy Side Improve Execution and Enhance Operational Efficiency," Greenwich Associates found that, among participating institutional investors using outsourced trading desks, 71% were extremely satisfied with the service.

As our industry continues to change, it is becoming clear that supplemental trading resources and expertise can be a vital and often indispensable resource for much of the buy-side community. MME

*Aaron Hantman is CEO of Tourmaline Partners.*

# Biggest net fund inflows of the decade

By Andrew Shilling

Over the last decade, the 20 funds with the biggest net inflows gathered roughly $1 trillion in assets. With around $3.4 trillion in combined AUM, these mutual funds and ETFs have all benefited from the industry's ongoing trend toward passively managed investment products, says Greg McBride, senior financial analyst at Bankrate.

"Fund flows over the past decade reflect the increased movement toward passive, or index, investing," McBride says. "Even the actively managed funds seeing the biggest inflows have expense ratios below 0.5%."

Fees among the top 20 were significantly lower than the industry average, data show. At around 14 basis points, these funds were 34 basis points cheaper than the 48 basis points investors paid for fund investing on average last year, according to Morningstar's most recent annual fee survey, which reviewed the asset-weighted average expense ratios of all U.S. open-end mutual funds and ETFs.

The flow leaders underperformed the S&P 500 and Dow over the same period, which returned 14.82%, as measured by the SPDR S&P 500 ETF (SPY), and 14.71%, as measured by the SPDR Dow Jones Industrial Average ETF (DIA), respectively. "A portfolio diversified among the entire U.S. stock market, international stock markets, and the bond market can be had with three low-cost index mutual funds or ETFs," according to McBride. "The massive inflows to such a strategy over the past 10 years underscores the simplicity and low costs investors are craving." MME

| | Ticker | 10-Yr. % Returns | 10-Yr. Flows (millions) | Expense Ratio | Net Assets (millions) |
|---|---|---|---|---|---|
| iShares Core S&P 500 ETF | IVV | 14.78 | $91,893.10 | 0.04% | $174,649.85 |
| Vanguard Total Intl Stock Index Inv | VGTSX | 6.83 | $88,268.41 | 0.17% | $372,473.11 |
| Vanguard 500 Index Admiral | VFIAX | 14.82 | $81,279.18 | 0.04% | $479,625.62 |
| Vanguard Total Bond Market II Idx Inv | VTBIX | 3.53 | $76,174.39 | 0.09% | $178,017.81 |
| Vanguard Total Stock Mkt Idx Adm | VTSAX | 14.92 | $69,857.12 | 0.04% | $804,465.22 |
| Vanguard Total Bond Market Index Adm | VBTLX | 3.61 | $63,545.47 | 0.05% | $217,698.32 |
| Vanguard FTSE Developed Markets ETF | VEA | 7.36 | $63,382.90 | 0.05% | $114,302.24 |
| Vanguard FTSE Emerging Markets ETF | VWO | 5.76 | $53,739.24 | 0.12% | $89,093.54 |
| SPDR S&P 500 ETF | SPY | 14.72 | $52,896.10 | 0.09% | $260,502.60 |
| iShares Core US Aggregate Bond ETF | AGG | 3.57 | $49,883.04 | 0.05% | $60,977.54 |
| American Funds Europacific Growth R6 | RERGX | 8.37 | $49,141.00 | 0.49% | $154,639.26 |
| Vanguard Interm-Term Tx-Ex Adm | VWIUX | 4.01 | $37,778.64 | 0.09% | $66,232.12 |
| Strategic Advisers Core Income | FPCIX | 5.02 | $34,230.58 | 0.47% | $40,968.16 |
| Vanguard Value ETF | VTV | 13.77 | $31,224.88 | 0.04% | $79,901.42 |
| Dodge & Cox Income | DODIX | 4.99 | $30,865.90 | 0.42% | $57,421.58 |
| Vanguard Wellington Admiral | VWENX | 10.88 | $25,846.54 | 0.17% | $57,180.02 |
| iShares Core S&P Mid-Cap ETF | IJH | 14.85 | $25,540.21 | 0.07% | $48,632.48 |
| iShares Core S&P Small-Cap ETF | IJR | 15.39 | $24,812.83 | 0.07% | $43,303.03 |
| Vanguard Short-Term Investment-Grade Adm | VFSUX | 3.23 | $24,730.72 | 0.10% | $59,517.88 |
| Vanguard Real Estate ETF | VNQ | 16.20 | $22,114.92 | 0.12% | $63,829.05 |

*Note: Institutional, leveraged and funds with investment minimums over $100,000 are excluded. Daily returns as of 5/17/19. Month-end flows as of 4/30/19.*
*Source: Morningstar Direct*

# Mutual fund flows

($ millions)

| | | Equity | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Domestic | | | | | | | World | | |
| Date | Total long-term | Total equity | Total domestic | Large-cap | Mid-cap | Small-cap | Multi-cap | Other | Total world | Developed markets | Emerging markets |
| **Estimated weekly net new cash flow** | | | | | | | | | | | |
| 5/29/2019 | -1,714 | -1,692 | -2,035 | 421 | -618 | -196 | -1,037 | -605 | 343 | 144 | 199 |
| 5/22/2019 | 1,144 | -1,677 | -3,221 | -607 | -676 | -398 | -836 | -704 | 1,544 | 1,675 | -131 |
| 5/15/2019 | -3,165 | -1,920 | -2,521 | 458 | -635 | -656 | -737 | -951 | 601 | 565 | 36 |
| 5/8/2019 | 7,258 | 308 | -1,093 | 309 | -378 | -46 | -606 | -372 | 1,401 | 1,202 | 199 |
| 5/1/2019 | -3,775 | -11,491 | -9,571 | -4,184 | -853 | -708 | -3,510 | -316 | -1,921 | -1,564 | -357 |
| **Monthly net new cash flow** | | | | | | | | | | | |
| 4/30/2019 | -13,845 | -42,427 | -26,822 | -13,898 | -2,751 | -2,424 | -4,766 | -2,983 | -15,605 | -16,641 | 1,036 |
| 3/31/2019 | -1,845 | -24,656 | -19,427 | -6,910 | -3,069 | -3,305 | -5,090 | -1,053 | -5,229 | -5,907 | 678 |
| 2/28/2019 | 20,676 | -12,582 | -10,858 | -4,801 | -1,369 | -520 | -3,910 | -258 | -1,724 | -2,595 | 871 |
| 1/31/2019 | 22,915 | 9,482 | 3,648 | 3,332 | -438 | 957 | 12 | -215 | 5,834 | 3,222 | 2,611 |
| 12/31/2018 | -183,181 | -89,360 | -43,897 | -1,044 | -9,467 | -8,793 | -15,230 | -9,362 | -45,463 | -39,179 | -6,284 |
| 11/30/2018 | -64,302 | -25,777 | -17,991 | -3,249 | -3,086 | -3,194 | -5,055 | -3,408 | -7,786 | -7,972 | 186 |
| 10/31/2018 | -61,778 | -19,030 | -15,090 | -107 | -4,338 | -3,064 | -4,195 | -3,386 | -3,940 | -3,493 | -447 |
| 9/30/2018 | -22,620 | -27,929 | -25,452 | -12,283 | -1,978 | -995 | -8,061 | -2,136 | -2,476 | -2,615 | 139 |
| 8/31/2018 | -17,743 | -24,453 | -23,108 | -12,975 | -2,019 | 1,179 | -8,006 | -1,288 | -1,345 | -1,469 | 124 |
| 7/31/2018 | -9,761 | -20,874 | -18,876 | -9,658 | -2,173 | 1,572 | -6,727 | -1,890 | -1,998 | -2,231 | 233 |
| 6/30/2018 | -16,154 | -19,894 | -24,292 | -15,216 | -2,714 | 1,453 | -6,517 | -1,298 | 4,397 | 4,810 | -413 |
| 5/31/2018 | -5,521 | -8,733 | -15,722 | -5,623 | -4,423 | 544 | -5,152 | -1,068 | 6,989 | 5,795 | 1,194 |
| 4/30/2018 | -6,622 | -9,293 | -12,669 | -702 | -1,128 | -104 | -3,965 | -6,771 | 3,376 | 1,620 | 1,756 |
| 3/31/2018 | 9,865 | 264 | -12,013 | 368 | -2,823 | -1,600 | -6,599 | -1,358 | 12,277 | 11,229 | 1,047 |
| 2/28/2018 | -11,902 | -8,369 | -19,562 | -1,655 | -2,858 | -2,634 | -9,412 | -3,003 | 11,194 | 9,455 | 1,739 |
| 1/31/2018 | 39,992 | -7,078 | -24,539 | -6,895 | -5,288 | -2,117 | -9,952 | -286 | 17,461 | 13,260 | 4,201 |
| 12/31/2017 | -28,528 | -38,329 | -43,086 | -18,741 | -4,770 | -3,202 | -12,395 | -3,979 | 4,757 | 4,294 | 463 |
| 11/30/2017 | -4,725 | -16,441 | -24,059 | -5,891 | -3,756 | -3,439 | -7,094 | -3,879 | 7,619 | 6,295 | 1,324 |
| 10/31/2017 | 11,607 | -15,971 | -22,091 | -7,338 | -2,411 | -2,109 | -8,386 | -1,847 | 6,120 | 4,952 | 1,169 |
| 9/30/2017 | 892 | -21,998 | -22,610 | -7,535 | -2,720 | -2,046 | -9,340 | -968 | 612 | 1,365 | -754 |
| 8/31/2017 | -86 | -16,493 | -24,559 | -7,221 | -3,513 | -2,555 | -8,213 | -3,057 | 8,066 | 6,641 | 1,425 |
| 7/31/2017 | 4,326 | -13,782 | -25,538 | -10,317 | -4,487 | -2,243 | -7,303 | -1,188 | 11,756 | 11,030 | 726 |
| 6/30/2017 | 7,718 | -9,412 | -18,484 | -13,216 | -3,147 | -2,341 | 1,965 | -1,746 | 9,073 | 7,496 | 1,576 |
| 5/31/2017 | 27,721 | 3,144 | -9,233 | 2,778 | -2,379 | -2,169 | -5,236 | -2,227 | 12,377 | 8,817 | 3,561 |
| 4/30/2016 | -4,520 | -23,767 | -19,455 | -5,800 | -3,381 | -2,405 | -7,327 | -542 | -4,312 | -3,413 | -899 |
| 3/31/2016 | 14,661 | -9,971 | -9,814 | -5,473 | -1,428 | 87 | -2,661 | -338 | -157 | 1,307 | -1,464 |
| 2/29/2016 | 8,492 | 8,779 | -2,332 | 2,072 | -2,871 | -351 | -525 | -657 | 11,111 | 10,509 | 602 |
| 01/31/2016 | -20,729 | -4,927 | -15,549 | 5,587 | -5,958 | -2,887 | -7,339 | -4,952 | 10,622 | 10,862 | -239 |

Note: Weekly cash flows are estimates are based on reporting covering 98% of industry assets.

Source: Investment Company Institute

# ETF flows

($ millions)

| Date | Total equity | Domestic equity | World equity | Hybrid | Total bond | Taxable bond | Municipal bond | Commodity | Total LT MF and ETF flows |
|---|---|---|---|---|---|---|---|---|---|
| **Estimated weekly net new cash flow** | | | | | | | | | |
| 05/29/2019 | -4,714 | -4,412 | -302 | -1,191 | 3,040 | 1,416 | 1,624 | 157 | -2,708 |
| 05/22/2019 | 3,827 | 3,722 | 105 | -736 | 4,565 | 2,486 | 2,078 | 178 | 7,834 |
| 05/15/2019 | -11,397 | -9,569 | -1,828 | -985 | 1,680 | -138 | 1,819 | -708 | -11,409 |
| 05/08/2019 | -8,305 | -10,162 | 1,857 | -837 | 7,592 | 5,261 | 2,331 | -745 | -2,294 |
| 05/01/2019 | -5,953 | -5,176 | -776 | -1,564 | 10,458 | 8,317 | 2,141 | -192 | 2,748 |
| **Monthly net new cash flow** | | | | | | | | | |
| 04/30/2019 | -15,632 | -5,347 | -10,286 | -4,963 | 40,411 | 33,133 | 7,279 | -1,829 | 17,986 |
| 03/31/2019 | -7,613 | -3,658 | -3,955 | -5,723 | 38,363 | 29,268 | 9,094 | -353 | 24,674 |
| 02/28/2019 | 2,227 | 3,604 | -1,377 | -2,423 | 45,094 | 34,155 | 10,939 | -1,493 | 43,405 |
| 01/31/2019 | -11,216 | -21,191 | 9,975 | -886 | 29,298 | 21,723 | 7,575 | 2,169 | 19,365 |
| 12/31/2018 | -57,445 | -28,957 | -28,488 | -28,169 | -49,413 | -49,511 | 98 | 1,173 | -133,854 |
| 11/30/2018 | 6,958 | 2,780 | 4,179 | -12,380 | -11,250 | -7,447 | -3,803 | 117 | -16,554 |
| 10/31/2018 | -10,542 | -12,009 | 1,468 | -11,251 | -32,405 | -28,140 | -4,264 | 336 | -53,862 |
| 09/30/2018 | -1,052 | 880 | -1,932 | -6,086 | 18,102 | 18,556 | -454 | -36 | 10,929 |
| 08/31/2018 | -3,953 | -6,658 | 2,705 | -6,187 | 19,585 | 17,259 | 2,326 | -2,322 | 7,123 |
| 07/31/2018 | -305 | 984 | -1,289 | -6,007 | 25,956 | 22,535 | 3,421 | -599 | 19,045 |
| 06/30/2018 | -26,524 | -20,980 | -5,544 | -7,085 | 19,650 | 17,049 | 2,601 | -2,450 | -16,409 |
| 05/31/2018 | 13,744 | 10,061 | 3,683 | -3,630 | 13,026 | 11,749 | 1,277 | -133 | 23,007 |
| 04/30/2018 | -27 | -7,411 | 7,384 | -3,752 | 22,405 | 24,176 | -1,771 | 2,310 | 20,935 |
| 03/31/2018 | -6,742 | -22,166 | 15,424 | -1,712 | 15,880 | 14,148 | 1,732 | 554 | 7,979 |
| 02/28/2018 | -19,502 | -41,442 | 21,940 | -3,439 | 1,694 | 2,706 | -1,012 | 1,026 | -20,221 |
| 01/31/2018 | 54,200 | 10,785 | 43,416 | 356 | 56,744 | 46,287 | 10,457 | 1,724 | 113,025 |
| 12/31/2017 | 8,940 | -9,047 | 17,987 | -3,334 | 19,158 | 19,491 | -333 | -528 | 24,237 |
| 11/30/2017 | 13,723 | -4,421 | 18,145 | -3,164 | 21,597 | 19,788 | 1,809 | -444 | 31,712 |
| 10/31/2017 | 23,928 | 3,162 | 20,766 | -1,818 | 38,705 | 36,110 | 2,595 | -747 | 60,068 |
| 09/30/2017 | 653 | -9,775 | 10,428 | -2,099 | 36,427 | 33,440 | 2,987 | 1,733 | 36,715 |
| 08/31/2017 | -6,149 | -22,766 | 16,616 | -3,685 | 29,532 | 25,078 | 4,454 | 2,393 | 22,091 |
| 07/31/2017 | 7,402 | -12,520 | 19,922 | -2,001 | 31,702 | 29,139 | 2,564 | -3,532 | 33,572 |
| 06/30/2017 | 21,927 | -7,950 | 29,878 | -2,546 | 32,632 | 29,372 | 3,260 | 1,528 | 53,542 |
| 05/31/2017 | 23,363 | -10,750 | 34,113 | -1,549 | 36,372 | 33,070 | 3,302 | -449 | 57,736 |
| 04/30/2017 | 12,335 | -8,264 | 20,599 | -1,563 | 25,185 | 22,064 | 3,120 | 948 | 36,905 |
| 03/31/2017 | 24,562 | 9,421 | 15,141 | -1,924 | 37,797 | 36,562 | 1,235 | -531 | 59,904 |
| 02/28/2017 | 35,179 | 17,610 | 17,569 | 44 | 35,990 | 33,991 | 1,999 | 1,867 | 73,081 |
| 01/31/2017 | 20,678 | 5,093 | 15,585 | -1,976 | 35,519 | 31,037 | 4,482 | -637 | 53,584 |

Note: Weekly cash flows are estimates are based on reporting covering 98% of industry assets.

Source: Investment Company Institute