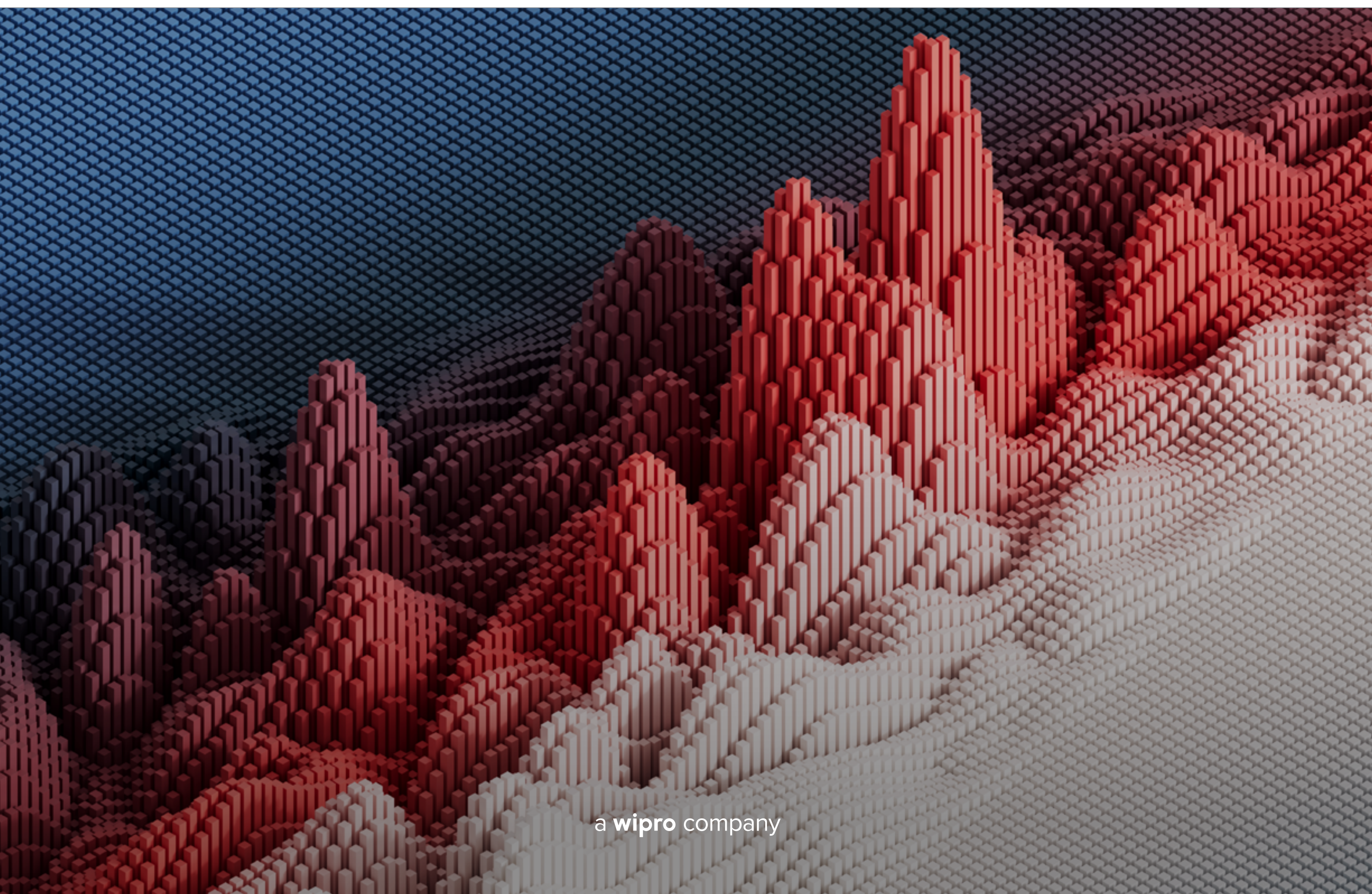
CAPCO

TOP US WEALTH MANAGEMENT TRENDS TO WATCH IN 2023

RESILIENCY IN AN UNCERTAIN ENVIRONMENT



The US wealth management industry enters 2023 facing significant headwinds. Against the backdrop of slowing macroeconomic growth and investment volatility, asset growth stalled in 2022 with US households losing nearly $7 trillion in net worth through Q3 2022.[1] To combat inflation and rising interest rates, investors are seeking both differentiated portfolio strategies (including private markets and direct indexing), as well as tactics to de-risk their portfolios within a looming bear market. Wealth managers are keen to show the benefits of long-term planning by leaning into alternative investments and customized product growth while continuing to prioritize advice, client acquisition and deepening relationships with next-generation investors.

While M&A activities continue to highlight wider consolidation across the industry, well-positioned firms have the opportunity to pursue takeover targets at more attractive valuations. Given longer-term cost-savings potential, firms should continue to prioritize strategic investments in Artificial Intelligence (AI), Machine Learning (ML) and ESG while reducing non-critical technology investments.

Wealth managers have demonstrated resiliency in navigating challenging environments in the past and kick off the year from a position of relative strength given these growth opportunities.

EXPANDING PRIVATE MARKET ACCESS

Investor demand for portfolio diversification, income and growth drove increased private market allocations in 2022. The underperformance of both equity and fixed income markets provided further tailwinds as investors reduced risk to public markets and set the stage for increased flows in the years ahead.

High investment thresholds and strict eligibility requirement barriers have resulted in a 90% concentration of private market assets in the hands of institutional and ultra-high-net-worth investors.[2] However, fintech distribution platforms combined with an easing regulatory landscape have enabled the democratization of alternatives downmarket to the high-net-worth (HNW) client segment. With nearly nine in 10 Financial Advisors intending to increase their allocations to alternative asset classes over the next two years, HNW investors are in focus.[3]

Despite the promising growth potential, financial advisors cite lack of liquidity, complexity, and fees as the main challenges for adopting alternatives in their practices.[4] Given the changing asset mix, wealth managers should prioritize addressing gaps in adoption by improving access, educating advisors and clients, and introducing new products to capture the growing revenue opportunity.

NEXT WAVE OF GROWTH FOR DIRECT INDEXING

Direct Indexing assets are expected to pass $1.5 trillion by 2025 as investors seek customized investment solutions that align with their investment mandates including generating tax alpha, ESG objectives and risk management.[5] Advanced technology, low trading fees and the proliferation of fractional shares has enabled access to investors across the wealth spectrum.

While firms continue to move down market related to investment minimums (e.g. Fidelity's $5,000 floor) and consider reducing fees (e.g. Charles Schwab), most of the asset growth is expected to come from high net worth and mass affluent clients.[6]

With only 14% of Financial Advisors currently using direct indexing for their clients, there is a significant opportunity ahead. Wealth and asset managers have made big bets on direct indexing the past few years as highlighted by M&A activity. As many firms transitioned from consolidation to implementation last year, 2023 represents a new era of growth for custom index solutions. To fully capture this uptrend, wealth managers should integrate these strategies as part of the portfolio construction process to create a hyper-personalized client experience.

DELIVER PERSONALIZED ADVICE AT SCALE

Investors increasingly expect a hyper-personalized client experience whereby advisors understand their preferences, provide actionable insights, and execute bespoke solutions.

70% of clients believe the degree of personalized advice is one of the most critical factors when deciding on a wealth advisor.[7] To meet a broader set of client expectations, wealth managers need to reimagine their operating and service models. Firms that evolve their tech stack to compile, analyze, and automatically extract insights from holistic client data within a central advisor's home workstation will be able to offer personalized advice at scale.

2023 will be a critical year for financial advisors and their ability to stay connected with clients and proactively anticipate their needs. During the pandemic, advisors that led with advice effectively retained clients and increased wallet share. An omnichannel offering has enabled advisors to significantly increase their client interactions. As the capabilities of the advisor evolves, their value proposition needs to be differentiated to serve next-generation clients.

LEVERAGING AI TO ENHANCE THE ADVISOR-CLIENT EXPERIENCE

The increasing commercialization of Artificial Intelligence and Machine Learning (AI/ML) technology has garnered the attention of the wealth management industry, attracting investments from firms that recognize its potential to revolutionize the advisory process.

The ability to automate recurring communications and offer tailored investment solutions aligned to life events provides advisors with significant value. Leading wealth managers have been focused on improving the advisor experience to increase productivity, enabling advisors to focus on high impact activities including financial planning and asset gathering.

The potential of AI continues to expand in innovative ways. AI chatbots (e.g. ChatGPT) have the potential to answer routine questions users may have about financial products, allowing clients to receive a near-instant response, and shielding advisors from a triage of client questions. Only complicated matters require human intervention, potentially improving advisor productivity by automating routine, tedious tasks, and more importantly, providing instantaneous clarity to clients on matters that require additional consultation with an advisor.

Firms who continue to further their investment in AI/ML solutions have the potential to redefine the advisor/client experience, and firms who do not heed these industry trends stand to be left behind.

CLIENT ACQUISITION

Wealth management firms are furthering investment in digital tools to assist advisors with lead generation, client acquisition, and improving the advisor/client matchmaking experience to increase client retention.

Lite planning tools, such as digital money coaches (e.g. Chase's "Wealth Plan"), prompt users to create a budget, form financial planning goals, and interact with investment simulations. These components nudge clients to interact with their finances and to connect with a financial advisor for more strategic approaches to build wealth, as contextualized within their personal financial profile. Financial planning is deeply personal, and meeting clients where they are enables advisors to leverage existing technology to demonstrate that an advisor can provide value when their financial needs become more complicated.

Other firms (e.g. Merrill Lynch's "Advisor Match") utilize technology to help clients find a financial advisor best suited to their needs. Digital advisor matching tools direct prospects through a behaviorally driven questionnaire to connect them with an advisor most suited to their unique financial situation.

These examples suggest that, while each wealth manager's interpretation of digital lead generation is different, the trend indicates further investment in new digital features will help advisors acquire (and retain) clients, and that further investment in personalizing the advisor/client experience is an increasing market expectation.

INDUSTRY CONSOLIDATION

A recent survey[8] of wealth managers suggests 2023 is poised for further industry consolidation as RIA aggregators focus on acquiring advisor teams. A staggering 44% of RIAs considered some sort of M&A activity in 2022, and 40% of respondents expected activity to increase pace this year.

As the largest wealth managers continue to look for ways to leverage their balance sheets in engaging disparate clients across the wealth spectrum, there may be further acquisitions of robo- and self-directed firms into traditional advisor-led businesses.

Acquisitions of wealth-tech firms will continue to drive growth both in revenue and customer base. Partnering, whether through product and platform delivery or outright acquisition, should continue to be top of mind for managers looking to drive growth beyond the traditional advisor recruiting model.

To fully capture the value of these transactions, firms will need operating models in place to ensure the smooth transition of advisors and their teams, orderly transfer and onboarding of assets, and impactful integration of new technologies and strategies. By tapping workflow automation across front and back-office business lines, wealth managers looking for a smoother ride of the M&A wave can efficiently free up advisor time for higher value additive activities.

THE GREEN(ER) GRASS ON THE OTHER SIDE

While ESG funds saw weaker[9] than expected inflows in 2022 compared to prior years, investment products focused on delivering values-based returns continue to drive client conversations. With over an eighth[10] of all investment dollars currently invested in products with an ESG mandate, there is no reason to expect the continuing trend towards a greener investment landscape to diminish.

What should be expected, is both the pace and intensity of "green" regulation to increase. From reporting requirements to clarification of ESG standards to naming conventions, the current regulatory framework is mired in opacity that the SEC and other regulatory stakeholders will be looking to clarify and codify this year.

Particularly for firms with multi-jurisdictional mandates, further investment into creating the regulatory, compliance, and data support structures necessary for the business lines' continued compliant operation is a chief priority.

Wealth management firms will need to continue to build the appropriate tools to support advisors in engaging clients around values-based investing and implementing specific and actionable investment solutions. Best-in-class tools will leverage digital best practices including both user experience and workflow resiliency to ensure both advisors and their clients are well equipped to do good by doing well.

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