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Personalised advice at scale: introducing mass tailored portfolio management

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STUART HOLDSWORTH, CEO & Founder, Financial Simplicity

PERSONALISED ADVICE AT SCALE: introducing mass tailored portfolio management

Why wealth management's generation of rent-takers will be overtaken by tech-savvy entrepreneurs

Introduction

Traditionally, much of the supply chain in the wealth management industry focused on product manufacturing and adviser distribution. For a more personalised service, portfolio management was largely manual and time consuming, prone to human error and costly to deliver - and only available to the wealthy.

I believe scaled personalisation through mass tailored portfolio management is the only sustainable solution for providing sufficient value to sufficient customer numbers, particularly the mass affluent, to sustain an ongoing business. Twenty years ago, I saw a disconnect between

In 2022 the landscape is massively changed. Retail investors have access to a wealth of information and investment tools that can help them to DIY their portfolio – with less time, more discipline and less effort than ever before.

innovations happening in products and distribution and the value consumers would receive if the industry continued down that road.

In 2022 the landscape is massively changed. Retail investors have access to a wealth of information and investment tools that can help them to DIY their portfolio – with less time, more discipline and less effort than ever before. They can put money into an ETF, use one of many brokerage and trading platforms, apps and robo, and they can find investment news, views and analysis in the form of podcasts, blogs, social media influencers, seminars and media articles, to name a few. For many people, going direct is a rational – and cheaper – choice.

The issue for intermediaries is that customers no longer see sufficient value in the former and many can't afford the latter. However, taking on all the responsibility of investing their nest-eggs is overwhelming. Smarter advisers and wealth managers have cottoned on to the demand for a better engagement model that centres around the customer, but this is still far from the norm.

Mass tailored portfolio management: delivering personalised investment strategies at scale

In today's world, if you want your business to thrive, then the customer must be at the heart of what you do, a concept known as customer-centricity. Consumers have personalised playlists on Spotify, tailored programming on Netflix, and their own driver service with Uber.

Wealth management has lagged in providing this level of personalised 'about me' portfolio management, except for in the case of the very wealthy. The solution for reaching those engaged investors who want a mix of tailored advice and to provide their own input, to "do it with me", is delivering personalised investment service at scale; a concept I've termed mass tailored portfolio management.

To sustainably reach and service this new, customer-centric market, a wealth management business needs to consider and find synergy in three key tenets: a long term, sustainable, customer value proposition; a long-term, sustainable economic model; and a long-term sustainable operational and regulatory model.

A long-term sustainable customer value proposition

Many Australians see paid financial advice as a service available only to the very wealthy. According to Investment Trends 2021 *Financial Advice Report*, two in five Australians say advice is out of affordable reach. However, 61 per cent of those surveyed identified that they had an unmet advice need, and 3.2 million were open to using an adviser in the next two years. 53% of investors on the ASX say they want a level of assistance but don't want to use the service offerings available largely today.

Clearly, there is a market of Australians who would like to receive some form of investment advice or help. For a wealth manager's service to be attractive and useful for this market, it must be delivered on personalised best interests basis, and probably on a different fee basis in order to be attractive. This means the generation of "rent takers" will soon have no business model left, while entrepreneurs who provide something better than one size fits all and centre their services around customers will build a strong engagement model.

To serve this growing middle ground between a one size-fits all, and completely bespoke investment proposition, intermediaries need to use technology to mass manufacture customer specific investment experiences. These techniques enable advisers to extend their engagement with prospective and existing clients to address the specifics of their situation and preferences with ease.

Advisers can extend the conversation beyond high level risk profiling to specifics from the investor along the lines of "I want 40% of my portfolio in FAANGs" or "I'm concerned about capital gains tax if you consider to sell my CommBank shares", "don't make adjustments for less than $10K on my $1M portfolio", or increasingly importantly to align an investor's portfolio to their specific ESG or other values. The more you can create a combination of a suitable investment strategy, plus the clients' input, the more value shifts away from managing the money to the stickier aspects managing the perspective of each individual client.

Clients notice the difference when their wealth manager manages their money in the context of their personal goals and situation.

A long term sustainable intermediary economic model

For a long-term sustainable engagement with clients by intermediaries, long term customer value must exceed cost of customer acquisition by some multiples.

With commission-based business revenue models out of the question, the relative value of one size fits all solutions is marginal as investors can do this themselves, and transactional brokerage revenues are very 'choppy'. Quality revenue comes largely from fees associated with how the customer sees ongoing value. Increasingly, judgement of value is relative to the costs of investors doing it themselves.

Retail investors have broad access to the markets, meaning value is not so much about buying and selling investments or products, as it is about having a process that can: save time, put knowledge in context of the investor's situation to determine what to buy and sell over decision blocks. This ongoing blend of professional expertise merged with customer perspective has to move beyond product selection into a more integrated offering, ie tailored portfolios.

A long term sustainable operational and regulatory model

Not only is it important to ensure that the customer sees sufficient value in continuing to pay for the service components as opposed to doing it themselves, it is also important to make sure that the way the income is sourced survives the test of operational robustness and fitting within current and future regulations.

With conflicted and product commission remunerations banned, the servicing of clients with a portfolio is a valid and demonstrable way to add value to clients, more so when this is personalised to the clients (and their best interests) also.

An operational model to support the delivery of personalised portfolios at scale then becomes the challenge. However, when implemented with supporting technologies it is the key driver of scalable service delivery in a non-conflicted manner.

While outsourcing to a third party is an option, doing this raises a fundamental question: what is the value proposition of the intermediary? Customers value involvement and interaction leading to tangible actions and outputs. Outsourced tailored portfolio solution providers will very much need to sharpen their engagement model and pricing structures to be competitive against firms that deliver tailored portfolio services themselves.

Bringing portfolio management propositions into an intermediary wealth management business is not so much about creating products for sale, which can bring conflicts, as it is about creating an ongoing, customer-customised value.

The next step now is how to make it scale. As discussed, many promoting external one size fits all investment models are seeing their margins fall, given customers think "I can just do it myself if I can get access to those products and capabilities."

A personalised approach has been shown to increase margins when premium fee structures represent premium service, however traditionally this has come at the expense of operational efficiency. The wealth managers at the forefront of change have found a way to service a gap in the market for a long-term, sustainable customer value proposition, and their fees, by offering personalised portfolio management at industrial scale.

Bringing portfolio management propositions into an intermediary wealth management business is not so much about creating products for sale, which can bring conflicts, as it is about creating an ongoing, customer-customised value.

In this situation, mass tailored portfolio management is more attractive than a one size fits all product proposition, it delivers more long-term value than either a once off transactional model or product referral model and operated with the correct infrastructure are the basis for a highly scalable, sustainable business model. With margin decline across the industry associated with products and infrastructure, it is the real opportunity to generate value, and in many cases is perhaps the only sustainable long-term model.

Conclusion

Like the disruption demonstrated by Netflix, Spotify and Uber, the next generation of financial services will have customers at the heart of everything it offers. To meet the advice needs of today's investors, intermediaries need to take a step back and rethink not only what's possible but actually essential for long term sustainability. In our rapidly evolving digital landscape, what's the future of your business model if you don't adapt to the demand for personalisation?

This is the new bar and an essential direction for the wealth management industry. However unlike Tesla with huge capital costs and lead times, everyone equipped with the right proposition and technology can deliver this to their clients today. ■

Stuart Holdsworth is the CEO & Founder of Financial Simplicity, a digital platform that brings efficiency and scale to portfolio management so that advisers, stockbrokers and asset managers can focus on delivering a more personalised, engaging experience for their clients.

BY SAM MORRIS, CFA – Senior Investment Specialist, Fidante Partners **& PETE ROBINSON,** Head of Investment Strategy and Portfolio Manager, CIP Asset Management

The case for combining public and private debt in one portfolio

Private debt is, for the most part, non-tradable, and asset managers and investors in the space generally view these investments as buy-and-hold.

However, unlike private equity, where a buyer must be found either by listing the asset on public markets, trade sale or selling to another private equity sponsor, in private debt markets the portfolio manager can manage the liquidity profile of the asset pool through the maturity and/or amortisation profile of the debt itself.

This is a very important distinction between the two asset classes, and the critical reason why blending public and private debt in a single portfolio is possible when compared to managing public and private equities.

Firstly, the illiquidity premium is also more valuable in a low-rate environment as its contribution to total return becomes more meaningful, as can be seen below.

As returns from this risk premium are driven by very different factors to cash rates, duration and credit risk, it thus adds considerable and meaningful diversification to both a blended public/private credit portfolio as well as to a broader multi-asset portfolio.

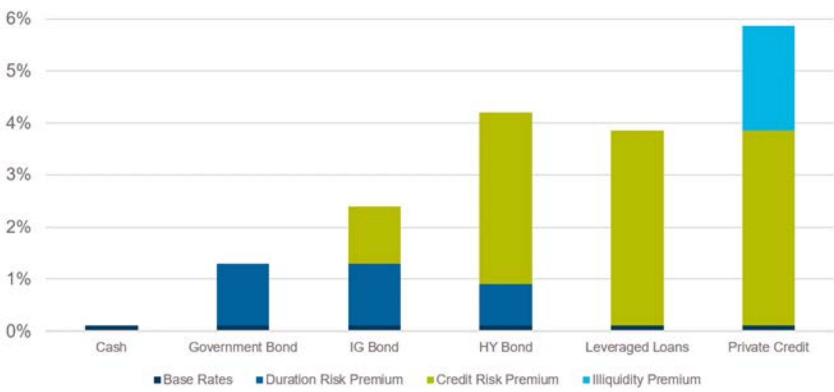
Isolating the return drivers in credit

In addition, the traditional advantages of robust security selection and asset allocation processes on the public-only side are further enhanced by the differentiated opportunity set available in private markets. Compared to distinct public and private portfolios, a one-portfolio solution can offer investors:

- A holistic approach to assessing the credit and liquidity-risk adjusted returns available across fixed income markets and to allocating capital opportunistically and appropriately
- Improved risk efficiency, as public and private investments can be considered in aggregate when managing the portfolio's industry, sector and credit-quality characteristics, and sector and market cap biases inherent to the public market structure can be diversified through private credit
- A mechanism to take advantage of short-term dislocations in capital markets and their knock-on effects in private markets that wouldn't otherwise be possible managing separate, fully invested allocations in both asset classes
- A relatively straightforward and efficient way to introduce private debt exposures into an investment program without additional staffing or monitoring costs or having to manage capital calls for closed-end institutional fund structures or additional equity market beta and liquidity risks for investors accessing private debt via listed investment trusts or companies.

A combined public/private portfolio also has an edge in capitalising on stressed financial conditions, as liquidity at the total portfolio level can be deployed across both public and private markets as appropriate to take advantage of market dislocations.

Annualised yield divided into different risk premiums



Source: CIPAM Calculations, August 2021

Put another way, it enables investors to average into private debt markets across the cycle in a low-risk way, lowering the timing risk that one might otherwise face putting capital to work in a private-debt only strategy that needs to be fully invested as fast as possible irrespective of the asset class relative value on offer.

> From a credit cycle perspective, the best risk-adjusted returns are often found in public credit right after market dislocation events such as COVID-19 as valuation recovery occurs, whereas private debt tends to offer better relative value during the middle and end of the credit cycle as banks ration credit and public market spreads become compressed.

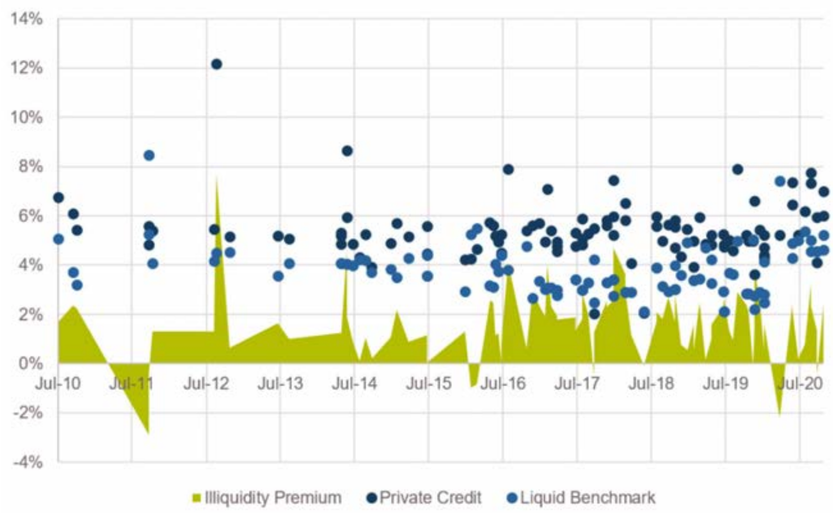
Furthermore, if you take the perspective that illiquidity premium is a real risk premium in the same vein that credit spreads or duration/term structure are as per above, then it can be helpful to analyse how it behaves relative to these other traditional fixed income risk premiums.

The variation in illiquidity premiums reflects the inefficiency of private markets, meaning there is a cyclical and idiosyncratic component. Amidst CIPAM's historical deals, for example, historical average illiquidity premiums are 2.2% but there is significant variation. Anecdotally, it appears that the level of the risk premium is lower when public credit spreads tighten (i.e. when public markets are performing well) and higher when they widen.

Historical illiquidity premiums in Australian and NZ credit

While it may seem counterintuitive, managers of combined public and private debt strategies can also utilise market liquidity to their advantage. In times of dislocation within the liquid markets, new issue volume can slow due to heightened uncertainty.

CIPAM originations 2010 – 2022



Dots represent a three-year discount margin on CIPAM-originated private deals. Liquid benchmark is the margin on a three-year bond of the same credit rating as the internal rating on the CIPAM private credit transaction

During these periods, agile managers can fill the void by providing much-needed liquidity to companies that might otherwise be able to tap public markets, often with enhanced terms. In addition, structures can be more lender-friendly due to the reduced number of financing solutions available.

Thus, actively rebalancing using the amortisation profile of private debt and “locking-in” long term illiquidity risk premiums at optimal times relative to public markets and vice versa can add considerable value across the credit cycle.

Institutional and retail investors need liquidity for any number of reasons. We would argue that asset managers can deliver more attractive liquidity characteristics and capture attractive illiquidity premiums across both public and private debt markets in a combined portfolio than in separate liquid and illiquid mandates that are run in parallel.

By delegating this asset allocation to the manager who is closest to liquidity conditions and relative value opportunities across both sides of the public/private spectrum, you can remove many of the frictions faced by an asset allocator having to manage these liquidity demands themselves and give them a known product-level liquidity profile (e.g. monthly liquidity with a 10% gate per month).

Part of the liquidity enhancement in a one-portfolio solution is simply a function of the structure of some private investments. The short duration and amortising features typical of private securitisation deals create natural liquidity over time, for example, while private corporate or real estate debt issues also may generate pre-maturity liquidity events should the interest rate and spread environment incentivise borrowers to prepay their loans.

Liquidity enhancement also can come from the seamless integration of public and private portfolio management efforts.

> Liquidity enhancement also can come from the seamless integration of public and private portfolio management efforts.

For example, short-duration public investments such as asset-backed securities or investment-grade floating-rate securities can be added to maximise portfolio income while also providing funding, over time, for private investments.

Asset allocators running separate allocations or products are less able to do this as they won’t be intimately familiar with the amortisation of the private debt profile and/or may have to hold zero-carry cash to fund capital calls for closed-ended private debt allocations with uncertain timing.

As the opportunity set evolves and expands — particularly in diverse private markets — combined portfolios may be better positioned to capitalise on innovative new structures as well. This could include innovative structured finance arrangements where unique economics can be extracted by virtue of meeting unique needs (for example, regulatory capital relief structures for banks or unique securitisation arrangements for non-bank lenders or other types of corporates).

Conclusions

The traditional way of looking at both equity and fixed income asset classes is to divide them strictly along public and private market lines, and to allocate to separate strategies accordingly.

While the nature of private equity favours highly binary and time-dependent liquidity profiles, hindering the ability to dynamically allocate across asset classes holistically from a relative value perspective in the same portfolio, the divide in liquidity between public and private credit is much more blurred.

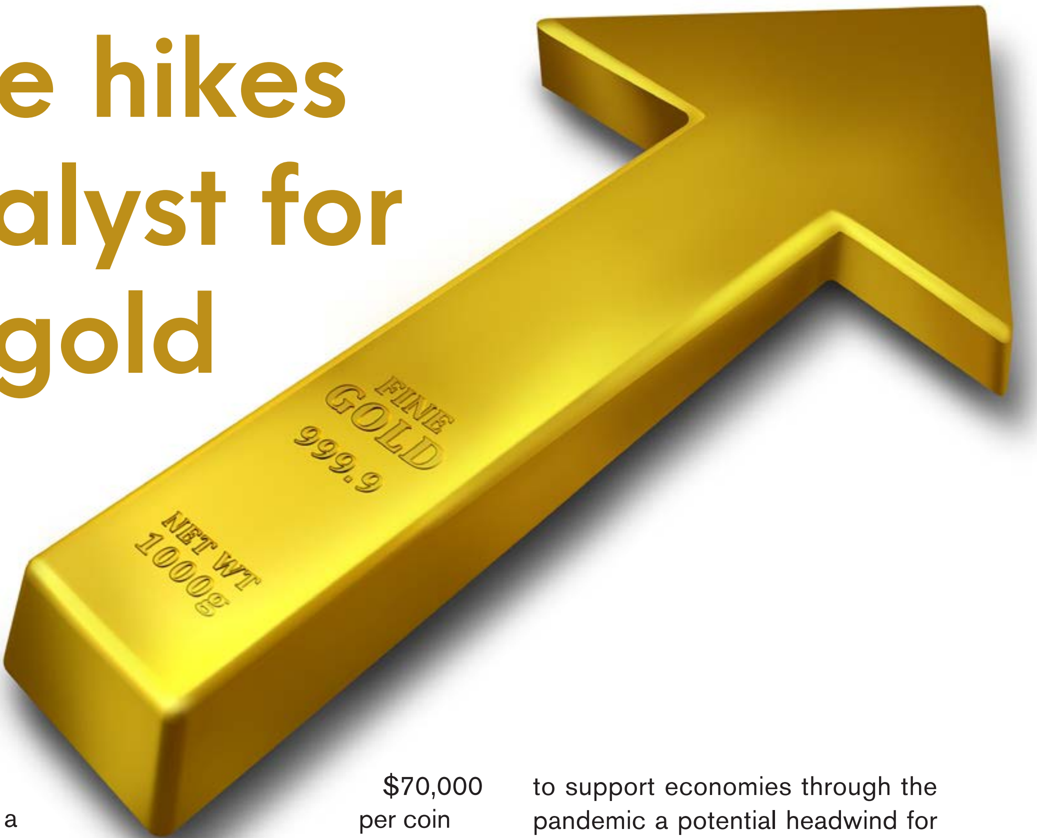
Furthermore, the liquidity premium itself has characteristics of being its own asset class from a diversification perspective, applying to both public and private debt assets, and time varying in quantum across the cycle.

As demonstrated above, these asset classes have complementary qualities that can be exploited to efficiently manage exposures throughout the cycle, while building a portfolio that provides diversification and yield premium relative to traditional fixed income.

Furthermore, an allocation to both public and private credit within a single portfolio management approach maximises an investor's ability to take advantage of dislocations across both markets. ■

BY JORDAN ELISEO, Manager, Listed Products and Investment Research, Perth Mint

Are rate hikes the catalyst for higher gold prices?



Since peaking in August 2020, gold prices have been in a corrective pattern, having fallen by around 15% to trade just below USD 1,800 per troy ounce (oz) by the end of January 2022. Several factors have driven the correction, including:

- A rising US dollar, which was up 6% in 2021.
- Stronger than expected economic growth.
- An incredibly strong rally in equities, with the S&P 500 up more than 25% in 2021
- Strength in cryptocurrency prices for most of 2021, with Bitcoin at one point pushing up toward USD $70,000 per coin

On top of these non-precious metal specific factors, gold itself was also overdue for a correction, having rallied by approximately 70% from below USD $1,200 to more than USD $2,050 oz between late 2018 and late 2020.

Won't higher rates sink gold?

In theory, gold prices should be on the back foot in 2022, with higher interest rates, and the conclusion of the various quantitative easing programs undertaken by global central banks to support economies through the pandemic a potential headwind for the precious metal.

The logic is simple enough. Gold doesn't pay an income, therefore if the interest rates one can earn in a bank account or term deposit are on the rise, then the opportunity cost of owning gold is going up, which is bearish.

In reality, history demonstrates very clearly that gold prices have typically tended to rise alongside increases in interest rates. The table below makes this clear, looking at rate hiking cycles, and movements in the USD gold price over the last 50 years.

Table 1: Rate hike cycles and USD gold price returns – 1972 to 2021

Date (start hike cycle)	Date (end hike cycle)	Effective Federal funds rate (start)	Effective Federal funds rate (end)	USD gold price (start)	USD gold price (end)	Gold price return (%)
31/1/72	31/7/74	3.5	12.9	47.60	157.30	230.5%
31/1/77	31/1/81	4.6	19.1	131.30	506.50	285.8%
31/10/86	31/5/89	5.9	9.8	404.66	363.17	-10.3%
31/12/93	30/6/95	3.0	6.0	390.50	384.15	-1.6%
31/5/04	30/9/06	1.0	5.3	393.80	597.80	51.8%
31/12/15	31/7/19	0.2	2.4	1060.91	1413.55	33.2%

Source: St Louis Federal Reserve, The Perth Mint, World Gold Council

Apart from the mid 1980s, where gold fell by 10%, and a very small decline between 1993 and 1995, gold prices have tended to rise, often quite considerably, in periods the US Federal Reserve is increasing interest rates.

Across the six rate hiking cycles highlighted in the table above, the gold price has increased by an average of almost 100%

This data highlights quite clearly that higher interest rates themselves are not necessarily bearish for gold, with movements in the stock market, the value of the US dollar and broader economic conditions also influencing demand for, and therefore the price of the precious metal.

Keep an eye on inflation

One factor to keep a close eye on in 2022 is inflation.

While gold doesn't always go up when inflation is running hot, it does have one of the best track records of any asset class as a hedge against rising consumer prices.

As an example, analysis conducted by The Perth Mint shows that the gold price in Australian dollars has on average risen by just over 20% in nominal terms in years local inflation was 3% or higher.

This can be seen in Table 2.

What makes the inflation outlook so interesting for gold going forward is that, at present, the market is expecting inflation rates to rapidly decelerate, and to stay low in the decade ahead.

This can best be visualised when considering the fact that while headline CPI rates hit 7% in the United States by the end of December 2021, the ten-year breakeven inflation rate, which measures what the market expects inflation to average in the next 10 years was just 2.56%.

That is the largest gap in 20 years between the current CPI rates and 10-year break-even inflation rates. This can be seen in the chart, which also highlights the USD gold price over this time period.

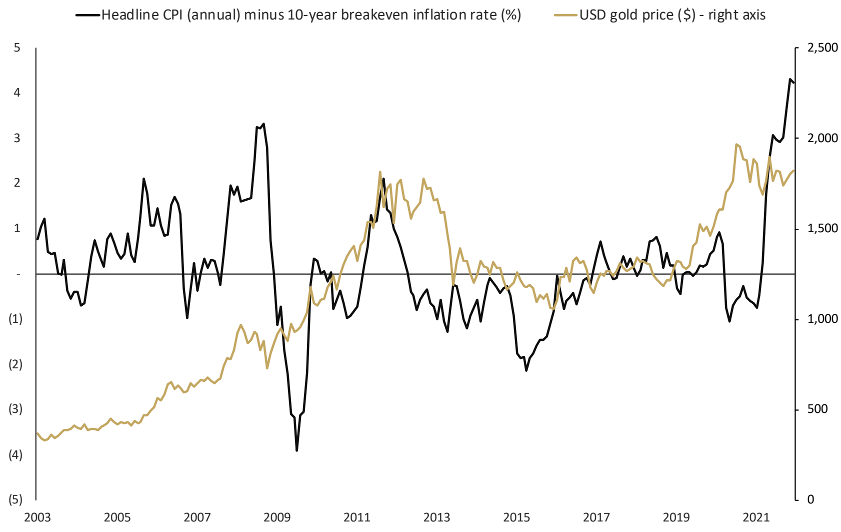
The only other time we've seen anything like this kind of gap was back in 2008 when there was more than a 3% difference between the headline CPI rate, and the 10-year break-even inflation rate.

Table 2: Australian inflation and average gold price returns (%) 1971 to 2021

Inflation environment	Number of years inflation in this bracket	Average nominal gold return (%)
Less than 3% p.a.	27	3.6%
More than 3% p.a.	23	20.4%

Source: The Perth Mint, Australian Bureau of Statistics, World Gold Council

Gap between current CPI rates and 10-year break-even inflation rates 2003 - 2021



Source: The Perth Mint, St Louis Fed, Bureau of Labor Statistics

While gold doesn't always go up when inflation is running hot, it does have one of the best track records of any asset class as a hedge against rising consumer prices.

Back then, like now, gold went through a corrective period, at one point falling by approximately 20%. That corrective cycle was short lived, and ended with an explosive move to the upside, with gold rallying by more than 150% in the three years that followed.

Given this history, and the fact there is plenty of room for CPI growth to fall yet still overshoot market expectations, there are multiple reasons to think the current inflation dynamics at play will ultimately lead to higher gold prices in the years ahead, irrespective of what happens with interest rates. ■

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BY ASIC

Joint review with HK SFC of global groups' FX activities

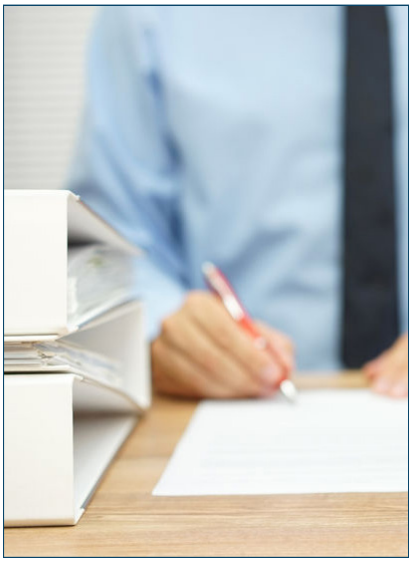
Together with the Hong Kong Securities and Futures Commission (SFC), ASIC has published a circular which highlights their observations from a review of selected firms' governance arrangements and internal controls for their wholesale FX activities.

The purpose of the review, which mostly included onsite inspections of global financial groups licensed by ASIC in Australia and the SFC in Hong Kong, was to assess their compliance with local regulatory requirements in their respective jurisdiction and their adoption of other industry guidelines.

The circular highlights ASIC's observations in the areas of supervision, risk management, trade execution, last look, protection of confidential information, mark-up, post-trade surveillance, and staff personal dealing and training.

For more details of the review conducted by ASIC and the SFC respectively, refer to:

- Report 652 Wholesale FX practices in Australia
- Report on the SFC's review of global financial groups' foreign exchange activities in Hong Kong ■



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Suspicious matter reporting

Wednesday 9 March | 1.00 to 2.00pm

Richard Lee, Director of the Industry, Education & Outreach team at AUSTRAC, will provide an overview of reporting suspicious matters to AUSTRAC, including what AUSTRAC is seeing, some do's and don'ts when reporting and how they play a critical role in protecting the financial system from serious crimes.

FASEA CPD: 1.00 hour Regulatory compliance and consumer protection | RG146: 1.00 Generic Knowledge

Richard Lee

An update on DDO implementation

Wednesday 16 March | 1.00 to 2.00pm

In addition to providing an update on DDO implementation, Corey McHattan, a partner with Ashurst, will also discuss how to address the challenges of undertaking the reasonable steps obligations for general and non-advice clients and the danger of straying into personal advice.

FASEA CPD: 0.5 hour Regulatory compliance and consumer protection, 0.5 hour Professionalism and ethics | RG146: 1.00 Generic Knowledge

Corey McHattan

Taking advantage of a new global equity investment order

Wednesday 23 March | 1.00 to 2.00pm

Sam Kazacos from Antipodes will outline how global equity portfolios should be positioned to benefit from the following new investment order thematic including inflation, China, new investment cycles generating activity and employment and other key global equity considerations.

FASEA CPD: 1.0 Technical competence | RG146: 1.00 Generic knowledge

Sam Kazacos

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A sign of things to come maybe

We are all planning to go to the voting booths in May and if the current opinion polls can be believed, there will be a new government in power in the back half of this year. This means a new person will be responsible for the SMSF sector and that is likely to be Stephen Jones, seeing he is currently the Shadow Assistant Treasurer and Shadow Minister for Financial Services and Superannuation.

So what might he have in store for the space should he get to drop the word 'shadow' from his title? Well the year kicked off with an industry function that saw him as the guest speaker and we might have got some indication of things to come.

One message Jones was keen to get out was the fact a Labor government would not dictate how superannuants are able to spend their money. He made this perfectly clear in his criticism of the COVID-19 financial relief measure allowing people the ability to withdraw up to $20,000 of their retirement savings to tide them over during the most trying period of the lockdown. To this end, he was supportive of the initiative but did not like the way it was implemented.

Basically, the Member for Whitlam was opposed to the fact individuals accessing this $20,000 were not limited in what they could spend it on and so there was no guarantee it would be used to support grocery bills and mortgage payments. Having said that, Jones also pointed out he was against dictating how people can invest or spend their superannuation. Conflicting message perhaps, but let's park this thought for a minute.

Later in his speech Jones indicated Labor would like to see superannuation monies playing a more important role in specific areas of the Australian economy. He said what he meant by this was that initiatives like infrastructure projects did not need to be fully funded by the federal government and retirement savings could be directed to do some of the heavy lifting too.

So what conclusions can we make from his presentation? I might be reading too much into this, but it would appear he would like to place greater measures within the superannuation system to, not quite force, but perhaps direct these monies into a particular direction the government would like.

This is unlikely to mean a portion of a superannuation fund's portfolio will have to be allocated to this or any other particular asset class, but it might mean trustees will be incentivised to direct some of the money under their control in the appropriate direction.

If this is how a Labor government would go about achieving its vision for how our retirement savings should potentially be used, it would at least be a more palatable solution for SMSFs.

It would mean the fundamental premise of running your own super fund would be left intact, that is, having the ultimate say in where to invest your own money and how to spend it once you are able to draw upon it, incentives or not. ■