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David and Goliath: The investment advisers taking on the big players

The small but mighty investment advisers taking on the big players

By Valentina Romeo

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Advisers are standing by their decision not to outsource investment decisions to discretionary wealth managers as competition hots up between boutique planners and scale players.

Some advisers have sought to outsource investment selection to discretionary fund managers following the RDR in an attempt to save on costs, time, and to get wealthier clients on board.

But others have chosen to stay away from outsourcing over fears the added degree of complexity in the investment chain will impact on value for money and transparency for clients.

Yet experts are also beginning to question whether retaining investments in-house is a sustainable solution for smaller firms as margins continue to be squeezed.

Money Marketing examines where smaller advisers may have an advantage over the investment “Goliaths”, as well as the potential gains they may be missing out on by declining tie-ups with bigger firms.

Justifying costs

Data from Platforum suggests the proportion of outsourced advised assets has gone from 18 per cent in May 2013 to 30 per cent in April 2017.

Over a similar time period, CoreData says the percentage of advisers outsourcing part of their clients’ investments has more than doubled, with 26 per cent of advisers now choosing to outsource.

CoreData figures show advisers carrying out all asset allocation in-house dropped to 62 per cent from 77 per cent in 2013. Nearly 5 per cent of advisers outsource all investments to a DFM, up nearly 3 percentage points in three years.

Capital Asset Management chief executive Alan Smith, who oversees around 15 staff, argues a small boutique financial planning firm like his can compete with the “combined resources” of the DFM market.

He says over a five-year period a CAM in-house portfolio marginally outperformed two indices provided by Asset Risk Consultants, an analysis group that monitors the performance of over 50 DFMs commonly used by advisers.

The CAM portfolio with a blend of 60 per cent equities and 40 per cent bonds, accounting for a 1 per cent charge, has returned 58.5 per cent versus the 52.3 per cent and 39.6 per cent for Asset Risk’s Sterling Steady Growth and Sterling Balanced Assets indices respectively.

Smith argues advisers and DFMs will encounter more FCA scrutiny on value for money as the regulator moves its focus on from pure asset management firms. He says: “How do other firms justify the extra layer of cost?

You’ve got four different people charging the client for investments and that has become extremely expensive. People are just not yet aware of all the layers of costs. It’s going to be hard to justify that.

“Our clients pay half what people are paying for advisers using DFMs. We have outside support though consultants such as Albion Strategic Consulting that provide research and governance.”

CoreData head of international research Craig Phillips says there is a “stigma” that DFMs imply larger costs for investors, but some strategies can be cost-effective.

He says: “DFM use might change and become like some platforms charging 40 basis points. Some DFM models can squeeze costs into something like that; it is not outrageous.

“If the long-term pressure is pushing down on price, the in-house solution is OK, but a lot of feasibility on that is hard to maintain.”

Signpost Financial Planning adviser Nigel McTear, who outsources most of his clients’ investments to DFMs, argues discretionary fund management is “the only way to professionally manage money”.

He says: “I carry the risk if the DFM isn’t good for my business and client but I don’t carry the risk of portfolio construction and monitoring the money. Other small firms might think they might do investments better than others but I question that. They want to hang on to every penny of client fees.”

McTear uses PortfolioMetrix, which shares his agnostic investment approach towards the active versus passive debate.

He says: “I see different clients want different things and there are limits on the investment proposition you can have. PortfolioMetrix allow the investors’ own investment preference to drive the solution. I thought this added consistency and academic rigour to my business.”

PortfolioMetrix charges clients 0.42 per cent. Signpost has an additional ongoing advice fee which is capped at 0.5 per cent.

As a result, McTear argues he would be able to spend his time acquiring twice as many clients while also charging less than his peers.

The FCA says average adviser ongoing charges range from a minimum 0.5 per cent to a maximum 1 per cent, and that has remained unchanged over the past year.

McTear says: “I struggled at the beginning on how to present this to clients and how we could justify the additional cost of the DFM. Obviously, if the DFM is 1 per cent plus you will never justify the cost of that.

“Investment returns are going to be inferior in the future, especially because of Brexit-related moves. Maybe you are now delivering inflation plus 1 or 2 per cent but that will wash out. By charging a high fee you’re not leaving a huge amount to the client.”

The path ahead

Analysts agree DFMs will continue to attract more flows from traditional advisers as advice firms continue to face cost and regulatory pressures.

Shore Capital equity analyst Paul McGinnis notes a growing number of advisers have started to obtain discretionary permissions where they are willing to take on the regulatory risk. He says: “Once the FCA started to focus on suitability post-RDR, some advisers said that was not their area of expertise and started

referring high-net-worth individuals to DFMs. This has been a good resource of growth for DFMs, especially businesses such as Brewin Dolphin.

“With the FCA placing a general scrutiny on high fees, some advisers see fees and margins being squeezed so they’ll go DFM. There are plenty of firms that are expert on mortgages or taxes for example and will leave the investment piece to other firms.”

Momentum Global Investment Management head of UK retail sales Andy Davies says a DFM has a deeper understanding of clients’ investment needs than other firms.

He says: “All we do is multi-asset but we don’t compromise like bigger firms. We are less financially compelled than big players holding multi-asset with their own funds, so their tendency is to buy their own funds.”

Reaching the minimum

However, Davies says a challenge for small wealth managers is to reach a minimum fund size.

He says: “Funds need to have a minimum of £100m before passing the first level of scrutiny but the danger is most funds perform the best when smaller. This can be frustrating because advisers might not look at that.”

Phillips argues there is also a “reverse power shift” at work.

He says: “All the power shifted from the manufacturers to the distributors and then to the advisers but now some of these ‘evolving’ distributors such as vertically integrated firms got the power back.”

But Davies says: “Big boys struggle getting into vertical integration and distribute to investors while maintaining their model. It may be that the direct-to-consumer market could be something they can get involved with.”

Elsewhere, developments in the pensions market may also play into smaller firms’ hands.

But McGinnis says the increasing need for advice on issues such as defined benefit transfers could lead small advice firms to incur higher costs, especially when advising on big sums.

He says: “Face-to-face advice is benefiting a lot from DB transfers because of the increasing complexity of the lifetime allowance. This will be good for firms, regardless of their size. But if it’s a small firm advising on a lot of money they’ll incur in larger professional indemnity insurance costs so there’ll be more challenges.”

Adviser view: Jonathan Davis, Managing director, Jonathan Davis Wealth Management

I have always viewed using DFMs as a short-term answer, but long-term I cannot see how the advice firm survives without always trying to find new clients. In the modern recurring income world, serve a small number of clients brilliantly (anywhere between 50 and 150 will suffice) and you will have a sustainable and growing practice. Push your minimum portfolio value up and up and therefore push your time spent obtaining new clients and your costs of servicing down and down. Margins soar, the firm works for you, rather than the other way around. You also build a great retirement fund.