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ADVISOR FIND CLIENTS  
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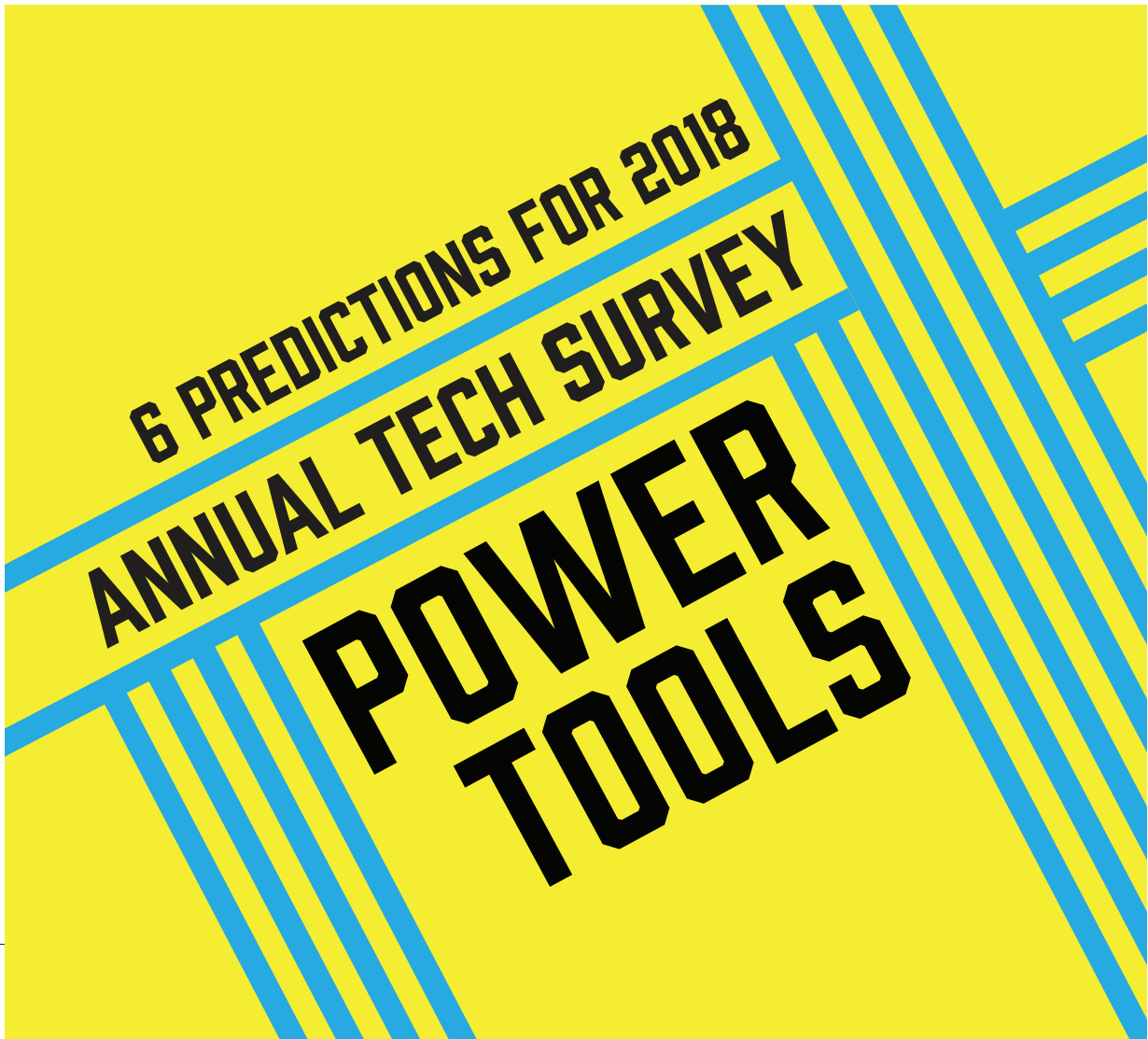
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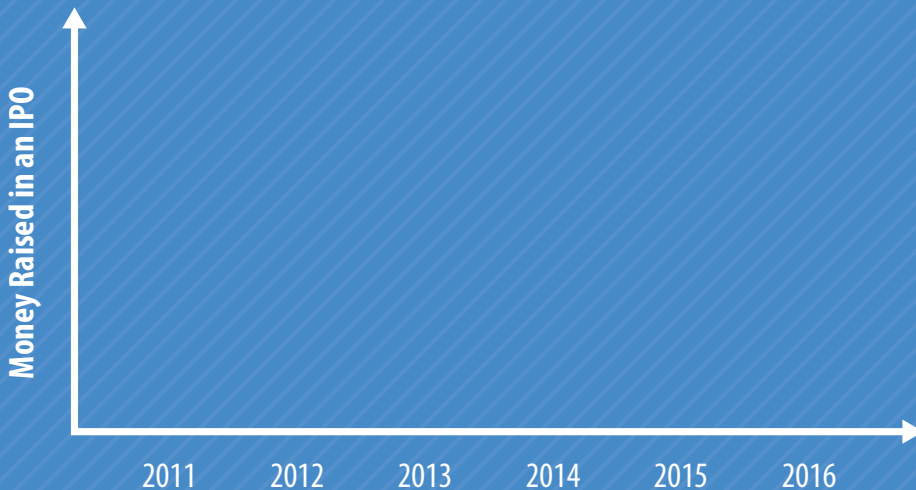
Which innovations and tools will have the biggest impact on advisors in the year ahead?

By Suleman Din

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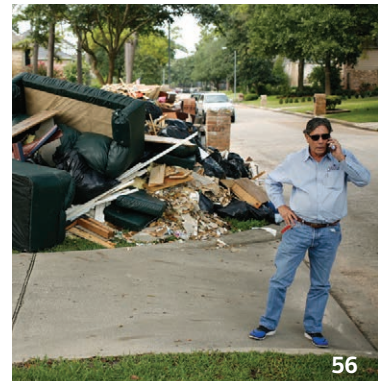
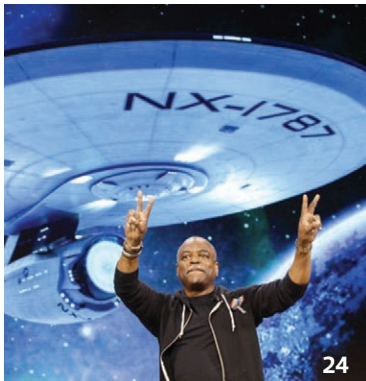


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Cheap, or fairly priced?



## Are These Funds Truly Undervalued?

With stocks surging, price-to-earnings ratios have been on the upswing in recent years. If your clients are worried about high elevations and want to focus on value, where are the lowest P/E ratios? To find out, we collected all equity mutual funds and ETFs with more than \$500 million in assets and ranked them: <http://bit.ly/2m984mj>.



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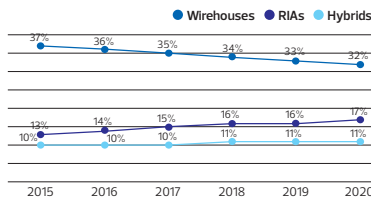
## Capturing the 'Benefits of Scale'

With advisors and assets fleeing the wirehouses, the RIA market may be gearing up for consolidation. While the four biggest firms picked up \$14 billion in client assets this year, regional broker-dealers and boutiques netted over \$27 billion, according to hiring announcements. With significant chunks of AUM flowing into the RIA space, firms are likely to consolidate to capture the benefits of scale, says Bill Van Law, president of the investment advisor division at Raymond James. Read the story at <http://bit.ly/2m8oBHa>.

## GUIDE TO GROWTH

### Wirehouses waiver

Projected share of client assets over the next three years



Source: Cerulli Associates

## EVENTS

### DECEMBER

**4-7**  
**MarketCounsel Summit**  
Miami  
<http://bit.ly/2e4lxlg>

### JANUARY

**29-31**  
**FSI OneVoice**  
Dallas  
<http://bit.ly/2zvofgV>

**31-3**  
**TD Ameritrade National LINC**  
Orlando, Florida  
<http://bit.ly/2g2ySix>

### FEBRUARY

**6-9**  
**Technology Tools for Today Advisor Conference**  
Fort Lauderdale, Florida  
<http://bit.ly/2z1ivdj>

# IF YOU THINK AN ANNUITY IS HARD TO EXPLAIN, TRY TELLING A CLIENT THEY MAY RUN OUT OF INCOME.

People trying to save for the future face many obstacles. A variable annuity with the purchase of an add-on benefit<sup>1</sup> can help address many of these challenges. So, isn't it worth the time to understand a product that can provide a protected lifetime income stream<sup>2</sup>, growth potential, and even the comfort of leaving money to loved ones?

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<sup>1</sup>Optional benefits are available for an extra charge in addition to the ongoing fees and expenses of the variable annuity. The long-term advantage of the optional benefits will vary with the terms of the benefit option, the investment performance of the variable investment options selected, and the length of time the annuity is owned. As a result, in some circumstances the cost of an option may exceed the actual benefit paid under that option. Death benefits terminate if the contract value falls to zero.

<sup>2</sup>Protected lifetime income of the optional lifetime benefits becomes effective at issue if the designated life/owner is age 59½ at issue, or upon the contract anniversary following designated life's/owner's 59½ birthday, provided the contract value is greater than zero and has not been annuitized.

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## EDITOR'S VIEW

### The Odyssey

Finding the perfect tech tool can take years. Results from our annual Tech Survey can help speed the journey.



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**THREE YEARS. THAT'S HOW LONG IT TOOK BALLENTINE PARTNERS** to research, adopt and customize its new CRM system. "It was a huge process," Ballentine's chief wealth advisory officer, Coventry Edwards-Pitt, told me on a visit to *Financial Planning's* offices several weeks ago.

Advisory firm teams can lose hours, days and sometimes even years poring through the many tech options. Even after rigorous research, software may still miss the mark. "It's an Odysseus-like search for the unfindable thing," Edwards-Pitt said.

In its annual Tech Survey, *Financial Planning* seeks to take some pain out of those quests. We asked almost 1,000 advisors about what they use, what works and what has missed the mark. Our comprehensive analysis ranks the most-favored products and shows which have fallen out of favor.

This year, we asked for the first time what technologies advisors believe will transform wealth management in the next one to three years. Robo advice came in at No. 2, closely followed by mobile technology.

I wasn't surprised by how high robo advice ranked. What surprised me was how few have actually implemented these tools. Just 18% of survey respondents said their firms had incorporated robo advice into their platforms. If the process to implement takes months or years, these firms better get moving.



#### FOLLOW THROUGH

It's one thing to say something is transformative. It's something else to use it and absorb the impact.

"Do advisors think robo advice will displace business?" asks contributing writer Harry Terris, who wrote our main feature story, "Power Tools." "Do they think it will be absorbed by incumbents looking to improve services? Will it broaden the pool of people using some sort of financial advice?"

Ballentine Partners probably already has its answer. "Our bread and butter work is our conversations we have with clients in face-to-face meetings," Edwards-Pitt told me. Even as the firm ramps up its use of cybersecurity, portfolio management and market tracking tools, it relies more than ever on relationship building and communication. "So much of planning is highly psychological, and technology is not going help very much with that," she said.

Still, survey respondents told *Financial Planning* that behavioral finance software would revolutionize even that. I'm looking forward to next year's survey.

—Chelsea Emery



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DATA-BASED INSIGHT FROM *FINANCIAL PLANNING* AND SOURCEMEDIA RESEARCH

## RETIREMENT ADVISOR CONFIDENCE INDEX

# A Bullish and Bearish Split

Advisors say some clients fear a correction in equities, while others are afraid to miss out on further potential gains.

**AN INTRIGUING SPLIT HAS EMERGED:** Clients are sharply divided between bullishness and bearishness, with very little middle ground. Some clients are increasingly nervous about the threat of a stock market correction, while others are emboldened by valuations that have weathered severe domestic and international political turbulences, advisors say.

Flows into equities, bonds and cash all increased in October as clients made divergent bets, according to the latest Retirement Advisor Confidence Index – *Financial Planning's* monthly barometer of business conditions for wealth managers.

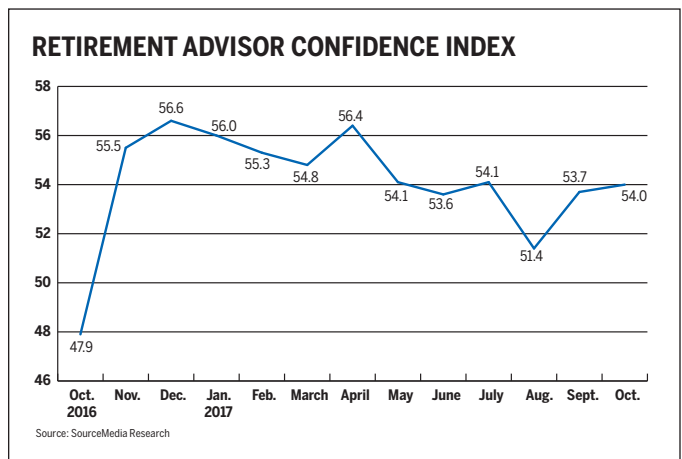
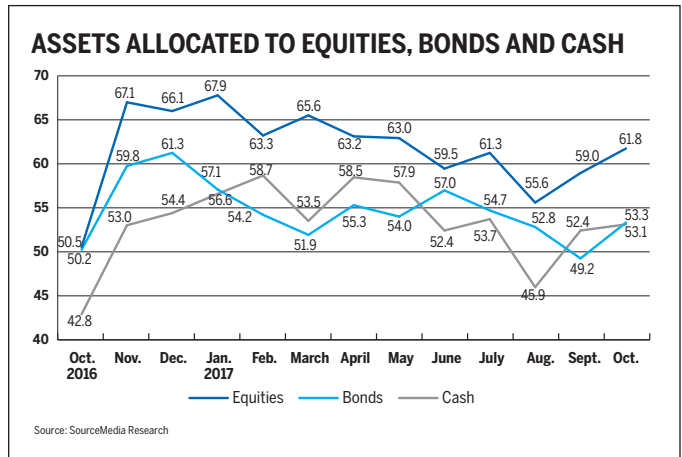
The component measuring allocations to equities rose 2.8 points to 61.8, allocations to bonds jumped 4.1 points to 53.3 and cash allocations were up 0.7 points to 53.1. Readings above 50 indicate expansion; readings below 50 show contraction.

In one camp, clients are moving to lock in gains and protect themselves. "I am raising cash for my clients by progressively selling the most overvalued assets," one advisor says.

But relatively low volatility and strong gains have drawn others into stocks, with some advisors saying a "fear of missing out" mentality was setting in.

According to another advisor, "Clients are either raging bulls or are very scared, little in between."

Despite the tension, the broad composite index ticked up 0.3 points to 54, extending a long streak in expansion territory. (The composite incorporates components tracking asset allocation, investment



The Retirement Advisor Confidence Index, published in partnership with ADP®, is created by the editors of *Financial Planning* and is based on a monthly survey of about 300 advisors. Visit [financial-planning.com](http://financial-planning.com) for more results.

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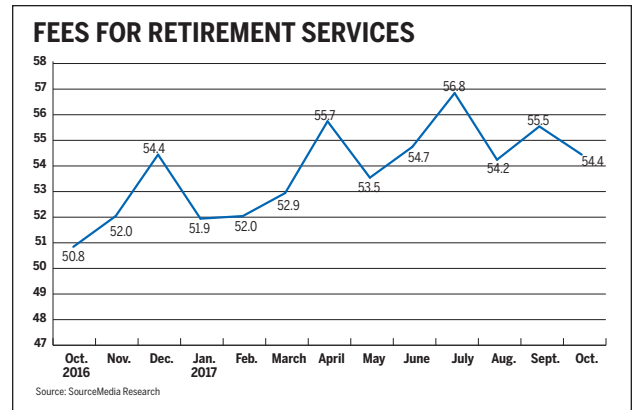
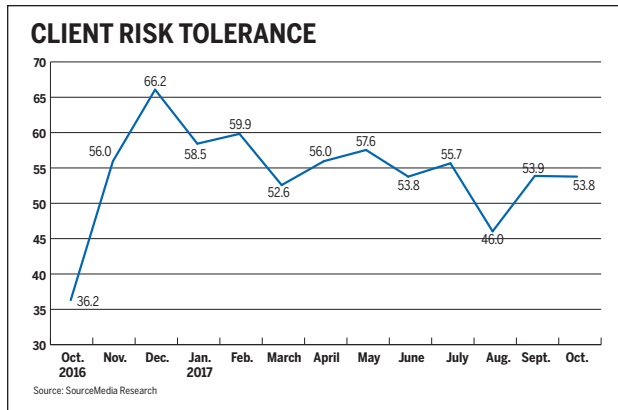
# BENCHMARK

product selection and sales, client risk tolerance and tax liability, new retirement plan enrollees and planning fees.)

Similarly, the component tracking client risk tolerance remained in expansion territory, despite slipping 0.1 points to 53.8. But whether clients are channeling bulls or bears, several

advisors say they're urging clients to stick to long-term plans.

The index component tracking fees charged for retirement services fell 1.1 points to 54.4. The reading has been above 50 for more than a year, as rising stock prices have increased assets under management. — *Harry Terris* **FP**

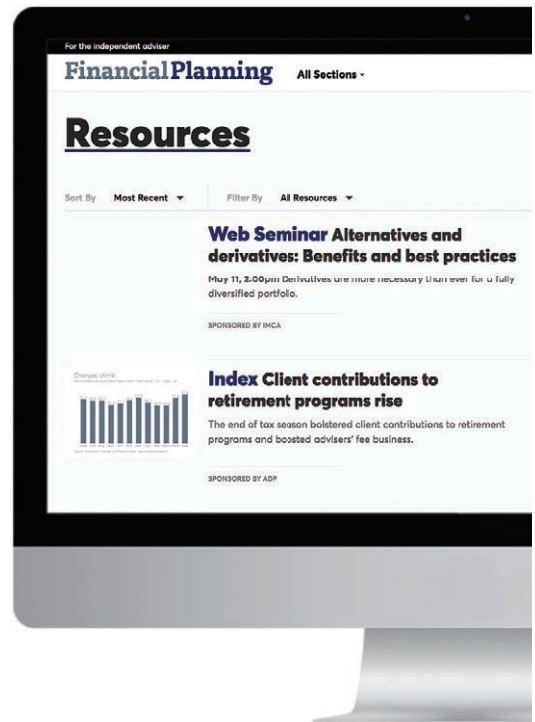


Harry Terris is a *Financial Planning* contributing writer in New York. He is also a contributing writer and former data editor of *American Banker*. Follow him on Twitter at @harryterris.

## Financial Planning RESOURCES

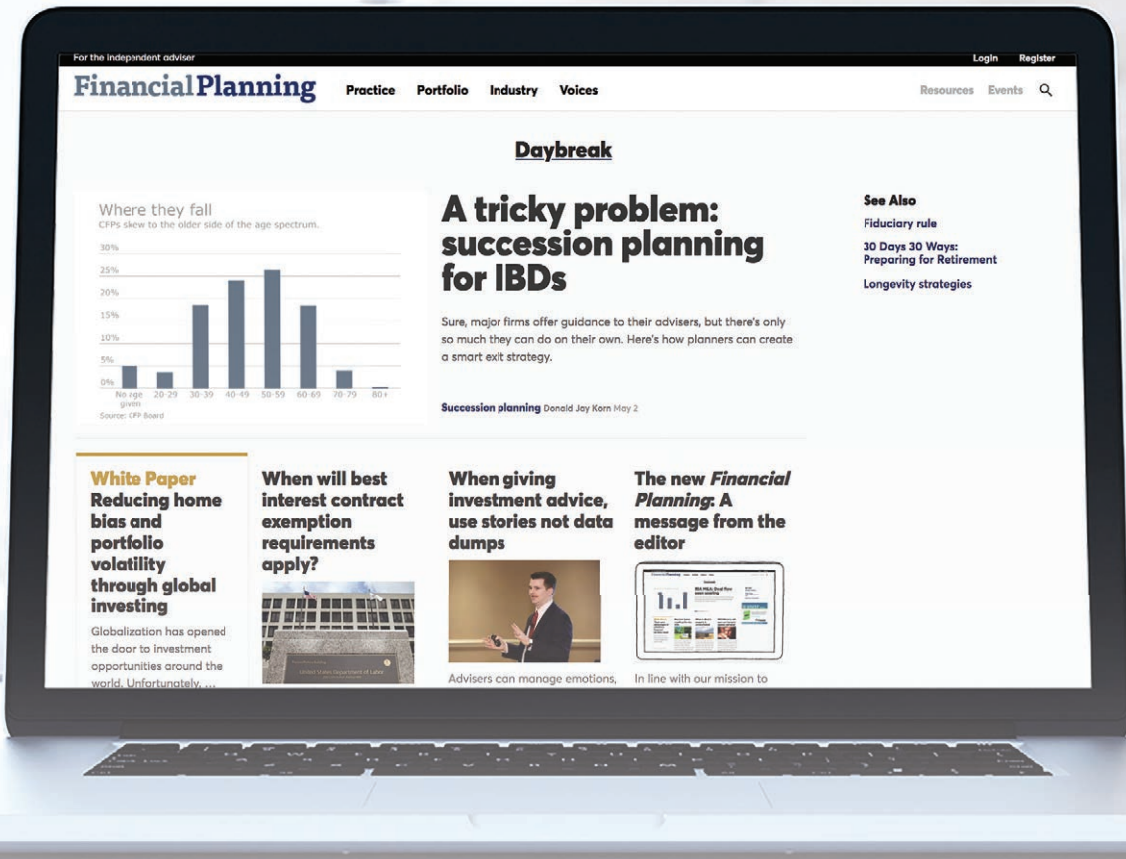
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## INDUSTRY INSIGHT **VERES**

# An Unnoticed Disruptive Force

Face-to-screen technology allows advisors to seek clients who live far from their offices, but it also increases competition, Bob Veres says.

**PLANNING FIRMS ARE STILL TRYING** to figure out what to do about the on-again, off-again fiduciary rule, and whether robo technology is friend or foe. But my candidate for the most disruptive force sweeping through our professional space is something much simpler and less-discussed: face-to-screen technology.

At nearly at every conference I attend these days, I hear from founding advisors who have moved to a warm location and communicate with their staff via telescreen, using one of a growing number of options to connect: Skype, Google Hangouts, FaceTime, Slack, GoToMeeting, Join.Me, ooVoo, Cisco WebEx, Zoom, Magnocall or Gruveo. If a key staff member moves, the firm sets up a video capability for him or her to continue working “alongside” the home office staff.

To give one example, at Searcy Financial in Overland Park, Kansas, the founder, Mike Searcy, has relocated to Naples, Florida, while his daughter, Jessica Maldonado, a company vice president, routinely dials in from Phoenix. The company’s director of marketing, Cali Gillespie, works out of her home in Manhattan, Kansas. Client meetings have Searcy, Maldonado and staff members in the home office all on the screen at the same time, sometimes with the client husband and wife teleconferencing in from different locations as well.

The growing feasibility of having a virtual firm with staff located here, there and every-

where has interesting lifestyle and recruiting implications. But the truly disruptive part is the impact on client relationships, and ultimately the value proposition of the planners themselves. Just about every planning firm has had clients move away to a new state. Video technology makes it much easier to maintain those client relationships.

But there’s also an impact on local clients who no longer have to drive through city traffic to meet in person with the planning team. Instead, they can conveniently teleconference in and participate in those meetings face-to-screen.

### **A BETTER VALUE PROPOSITION**

That, in turn, means that those client conversations can be quicker and more frequent. No longer does the planner have to schedule an hour in order to justify the commute time invested by clients. They can talk about whatever is going on in a quick chat and get off the line – and have these conversations whenever the client has questions or issues, rather than once a quarter. This has the potential to raise a firm’s value proposition and, at the same time, lower the time commitments of a client relationship.

But, most important, think about the marketing implications of a world that is moving increasingly toward face-to-screen relationships. When you can meet with people virtually, it removes the geographical barriers to marketing yourself and your firm.

**How do you take advantage of a trend that allows you to serve a client anywhere in the world? Specialization.**

No longer are you confined to working with clients who happen to live within 20 or 30 miles of your office. Now you can have close working relationships with people who live anywhere in the country – or, for that matter, anywhere in the world.

The end of geographic barriers for you and your firm is the good news. The bad news is that virtual client meetings open the door to every other advisor in the country – or the world – competing with you right there in your market. There is no reason that an ideal client working in an office upstairs from you in your building couldn't be meeting virtually with a planner based on the far side of the Mississippi. With increasingly cloud-based software and automated document signing technology, the office visit is not just unnecessary, it is going to look increasingly anachronistic.

## **FIGHT BACK**

How do you take advantage of this trend – or fight back against the tens of thousands of advisors who might already be poaching on your territory? I think the virtual trend is going to spur another trend: specialization.

If everybody is competing for business everywhere, that means a young doctor in residency will go online and look for a planner who specializes in helping young doctors in residency – even if that person lives a thousand miles away – rather than a general practitioner who works with anybody and everybody from a nearby office building, who would have to bone up on the career and financial options of a budding doctor.

So my first advice, particularly to younger planners, is to identify a specialty. It could be psychographic, like show horse owners, serious bicycling enthusiasts, art collectors or sport fishermen. It could be narrow professional niches like casino card dealers, rodeo clowns, freelance artists or diplomats posted abroad.

These niches wouldn't be feasible when you're limited to working only with clients in your immediate vicinity, but they make abundant sense in a world where clients are

doing a national search for people who work specifically with individuals like them.

Just as important, advisors are going to have to become more interesting in their web profile. Most websites have nice graphics that depict a comfortable retirement, bios of the staff and a map to their office location.

But when clients are conducting global web searches for just the right planner, regardless of physical location, they are going to be most attracted to working with planners whose sites have interesting interactive quizzes and questionnaires, YouTube videos where you answer questions you've heard recently from clients, plus blogs on financial topics like the new tax reform proposals and how much it costs to own a pet.

They may even do their own planning on your website. Recently, planning software programs like MoneyGuidePro, eMoney and Advizr have introduced features that would allow subscribing planners to put surprisingly robust planning capabilities up on their websites, so prospects can explore their financial options before making that on-screen appointment.

If this face-to-screen trend continues to gather steam – and why wouldn't it? – it could turn the whole planning world upside down. Regardless of the home office location, the founding planners and key staff could work from anywhere they choose and recruit talent from anywhere and link them into the work flows and meetings.

Searcy recently told me that since he moved to Naples and his daughter moved to Phoenix, they see more of each other than they did when she was working out of an office two doors down from his.

These distributed firms will have one or more very tightly defined niches that seek clients from anywhere in the country; hold shorter, more frequent meetings with them; and build more interesting web experiences as the front door to client relationships.

For those who remember "The Jetsons," the futuristic 1960s kiddie show, its "televi-sor" looks like where the planning profession is going – or, in some cases, is already. **FP**

**When would-be clients are conducting web searches for just the right planner, advisors are going to have to have a much more interesting online presence.**



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## ELITE ADVISOR **BOWEN**

# Give a Little, Get a Lot

Taking five relatively small steps can help you build a highly successful charitable planning practice, John J. Bowen Jr. says.

**ALL TOO OFTEN, FINANCIAL ADVISORS** overlook charitable giving as a low-priority item on their clients' to-do list. But for many of the most desirable clients – affluent individuals and families – philanthropy is a top-of-mind concern.

A vast majority of affluent investors claim to give to charity for altruistic reasons, rather than for the tax benefits. They're motivated more by impact, personal satisfaction and religious beliefs, according to a 2016 survey by U.S. Trust and the Indiana University Lilly Family School of Philanthropy.

Wealth managers who can guide these clients by offering comprehensive charitable planning can reap major rewards, differentiating themselves from the crowded field of advisors and generating significant revenue.

In my experience coaching advisors over 16 years, I've seen that the ones who are extremely successful at implementing charitable planning into their businesses tend to take these five steps:

### **THREE MAIN GROUPS**

**1. Know the philanthropic affluent.** To have a thriving charitable planning practice, you need one thing: clients who want help with charitable planning and who can pay you an appropriate fee for doing so. Top advisors in this space are adept at finding, courting and signing up high-net-worth individuals and families who need charitable planning guidance and expertise. They don't leave this to

chance – they actively and systematically get in front of three main groups of investors:

- Ultrawealthy investors, with net worth of \$100 million or more.
- Self-made millionaires, with \$5 million to \$50 million of net worth. Among this group, 90% are involved in activities such as fund raising for charities.
- Some 70% of the more than 300 wealthy business owners we surveyed want to become more charitably minded in the coming years.

Most commonly, advisors build alliances with the gatekeepers who serve these groups – such as estate planning attorneys and CPAs – to gain access.

### **ALTRUISTIC INTENTIONS**

**2. Understand their motivations.** Our various research efforts over the years reveal that anywhere from 60% to 90% of the affluent want to make a meaningful difference through philanthropy.

Among the 91% of high-net-worth households who donated to charities in 2015, the top causes included charities that provided basic necessities, religious organizations, health services and combination charities like the United Way, the United Jewish Appeal and Catholic Charities.

Of course, even clients with the most altruistic intentions also like to make sure their money stretches as far as possible. Successful charitable planning firms recognize

**An estimated 60% to 90% of the affluent want to make a meaningful difference through philanthropy, studies show.**

that to really wow affluent clients, they need to be able to help them maximize the impact of their giving as well as realize the best possible tax benefits.

## BEING WELL-VERSED

**3. Understand the specific expertise you need and get it.** Charitable planning-based firms excel in two areas of expertise:

- *Technical.* That means having a strong understanding of core gifting strategies like charitable trusts, private foundations and donor advised funds. That doesn't mean being the expert in all facets of these tools, but it does mean being well-versed in them.

In addition, it's important to understand how to integrate these gifting strategies into broader-based wealth planning – like estate planning, asset protection and even cross-border planning for very wealthy clients.

Having the ability to provide charitable solutions that work in concert with solutions in those other areas of advanced planning can really differentiate you.

- *Business.* You have to be able to work effectively with wealthy clients to maximize those relationships, and know how to systematically access new wealthy clients interested in charitable planning – through introductions and referrals to prospects, relationships with influencers in the charitable space and so on.

For advisors who already have this expertise in-house, leverage it to the full extent. But for top advisors who don't, source expertise from outside professionals. You can partner with private client lawyers and organizations like Foundation Source to gain access to resources that might be too costly to have in-house.

## REFERRALS

**4. Cultivate referrals from clients and other professionals.** We surveyed more than 800 professionals who focus on the affluent and

who have earned at least \$300,000 annually for the past three years, to get a sense of what they have to say about the market for charitable planning. These were professionals like trust and estate attorneys, investment advisors, accountants and insurance specialists.

We found that 93% said that having more wealthy clients is critical to their continued success. But 80% said they don't think they are very effective at generating new business from their existing wealthy clients. That means these professionals are always out chasing after new clients, while overlooking big opportunities to generate more revenue from the existing affluent clients they already have.

This can present a major opportunity for you, if you're adept at providing comprehensive charitable planning and you become known as a go-to resource among these professionals.

By offering a new service to their clients, you can create a win-win for your business and for theirs, cross-referring clients between your practices. Clients will

be more likely to generate referrals, as well.

When we surveyed 474 wealth managers, we found that as a group, they received 1.9 referrals on average over the past two years. But the professionals who worked with philanthropic affluent clients to facilitate their planned giving received an average of 3.6 client referrals.

## STAND OUT

**5. See how charitable planning can differentiate your business.**

A vast majority of advisors – 90.7% – say they have planned-giving expertise. But guess how many are actively promoting that expertise with clients? Just 17%.

This gives you a tremendous opportunity to stand out and be successful on purpose by repositioning your practice as an authority in the world of charitable planning. **FP**

**Having the ability to provide charitable solutions that work in concert with solutions in other areas of advanced planning can really set you apart.**

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## IN PRACTICE **FOSS**

# The Borg of the Planning Universe

Robo advising technology will swallow up everything in its path. Advisors need to embrace it to 'live long and prosper,' Kimberly Foss says.

### TREKKIES AMONG MY READERS

Undoubtedly already know about the Borg, some of the worst baddies in the "Star Trek" universe. For those unfamiliar with the series, the Borg are part humanoid, part machine cyborgs that swallow up – or, in their words, "assimilate" – any civilization in their path, incorporating it into their hive-mind known as the Collective.

In our industry, robo advisors are much like the Borg, and planners who resist or deny their technology may soon find themselves in a rapidly shrinking client universe.

A little over a year ago, the research firm Cerulli Associates predicted that by 2020, assets managed by robo advising platforms would be \$489 billion, some 26 times greater than the \$18.7 billion managed in 2015.

Technology-driven investment platforms are clearly not a passing fad. They have become the vehicle of choice for millions of investors who embrace the notion that technology can deliver investment advantages in both value and cost.

Given these shifts in the landscape, I recently decided to incorporate a robo advising component, RobustWealth, into my practice to reach a class of investors that would have been impractical for me to serve in a one-on-one capacity. (Disclosure: I am on the advisory board for RobustWealth.)

RobustWealth uses an open-architecture approach that enables me to offer clients with smaller portfolios the same mutual

funds and research services that I previously made available only to those with at least \$1 million in AUM.

Additionally, RobustWealth can handle billing and remittance, portfolio rebalancing, and online account opening and management. It can also offer customized goal-based portfolio construction. The platform harnesses data analytics to help clients glide from their starting portfolio to their ending portfolio, adjusting risk factors as clients approach their determined goal.

All of this can be wrapped in a container that is indistinguishable from my firm. It's a white-label platform that allows me to customize and brand these services in a way that is unique to my practice.

### AND THE FIELD IS GROWING ...

This isn't the only option available for clients. Many of the largest names in the industry have introduced or are mulling robo advising platforms.

The options range from beginner sites like Acorns, Stash, Betterment and Hedgeable (each with a minimum required investment of \$0 to \$5) to those like Wealthfront, Liftoff, Schwab's Intelligent Portfolios and Ally Invest (formerly TradeKing) that require \$500 to \$5,000 to get started.

Advisory fees are in the range of 0.25%–0.4% (some may charge a flat monthly fee for accounts under a certain amount) and other fees may be assessed for various services.

**Planners who choose to resist or deny robo technology may soon find themselves in a rapidly shrinking client universe.**

These services are geared primarily to DIY investors who are inclined to bypass traditional financial advising relationships in favor of reduced expenses.

Betterment Institutional (the unit scaled for use by professional advisors), Fidelity Institutional Wealth Service and Schwab Institutional Intelligent Portfolios are just three of the many enterprises aimed at helping advisors retool their offerings to

to be even more difficult in the robo world. **DIFFERENTIATION:** It's also important for advisors to avoid cannibalizing their highest AUM accounts. Thus, clearly differentiating (and communicating) the deliverables and levels of service available on the robo platform will be essential.

High-net-worth clients who are the foundation of our practices should not be tempted by the low fees of a robo advising

**Technology-driven investment platforms are clearly not a passing fad. They have become the vehicle of choice for millions of investors.**



BLOOMBERG NEWS

Actor LeVar Burton offers a non-Trekkie greeting at a "Star Trek" video game event in 2016.

appeal to younger investors or those without the assets to qualify for more traditional services.

While fusing the human side of your business with robo technology has its advantages, there are also some things advisors should be wary of:

**FEE STRUCTURE:** As I have worked through my own process, I have given careful thought to the fee structure for clients utilizing my robo advising platform. Most of us who have endured the trials and tribulations of establishing a fee-based practice know the frustrations that come with trying to strike just the right balance between value and cost. Even when we have established strong interpersonal relationships with our clients, it's not easy to go back and say, "I need to raise my fees." This is likely

platform. Instead, advisors should emphasize and deliver the higher levels of service and attention those clients expect.

**TRIAL BY FIRE:** Robo advisors have yet to be tested by a serious or prolonged bear market. As we learned from the Flash Crash of 2010, technological advances can have unintended side effects. So, advisors who integrate robo advising into their practices will need to be attentive; robo advising is not cruise control for portfolios. We need to carefully consider how to meld the human touch with the high-tech advantage.

All this being said, I still believe that we should not fear robo advisors. In the brave new world of investment advising, robo advisors are one more tool we can use to help our clients – and our practices – to "live long and prosper." **FP**

**Kimberly Foss**, CFP, CPWA, is a *Financial Planning* columnist and the founder and president of Empyryon Wealth Management in Roseville, California, and New York. Follow her on Twitter at @KimberlyFossCFP.



## PRACTICE CONSULTANT **KAUTT**

# On the Right Track

The secret to tripling your AUM in a decade is putting in the hours — and following the results, Glenn G. Kautt says.

**SOME ADVISORS TELL ME THEY HAVE** a difficult time talking to prospects. These advisors say they are frustrated because their marketing and sales techniques just aren't working.

So, what does work?

### **PERFECT YOUR PRACTICE**

For one, it takes time.

Top performers in fields such as medicine, athletics and science put 10,000 to 15,000 hours into perfecting their skills, author Geoff Colvin showed in his best-selling book "Talent is Overrated." And even after reaching the top rung of achievement, these superstars remained immersed in their work, day in and day out.

Chuck Yeager, the first pilot to break the sound barrier, in his autobiography attributed his skills to years and years of practice. As a test pilot, he flew unproven and often very dangerous experimental aircraft. He engaged in air combat. He chose duty stations requiring daily flights. All that added up to more than 20,000 very difficult hours of flying over almost 30 years.

Stop and ask yourself how many hours of formal training you've received on prospecting and conversing with potential clients. Is it more than 2,000 hours?

In the past 10 years, how much time have you spent actually talking with clients and prospects, either on the phone or face-to-face? Is it more than 10,000 hours?

When you rigorously track your hours and appointments, you'll see how much work you've done perfecting communications with others. More importantly, you'll know the results of those efforts. If you don't have explicit records, you probably aren't happy with the results. Worse yet, you don't know why things are not working.

I recently reviewed my calendar to see how many client or prospect meetings I'd had in the first four months of the year. Here's what I found:

### **COUNT THE HOURS**

Surprise! The calendar I was reviewing was from 1998. At that point, I'd been an advisor for 15 years and a CFP for 11 years. I also owned my own firm, which had \$170 million in AUM.

Assuming those meetings averaged two hours each, I calculate that I spent about 1,500 hours meeting with prospects and clients that year. In other words, about 50% of my work time was devoted to client relations and relationship building.

Tracking has served me well in my professional life. My business nearly tripled in size over the next decade, reaching \$500 in AUM by 2008. I continue to rely on this analysis: At my firm today, every advisor has his or her goals reviewed regularly by a supervisor. Monthly performance numbers are published for every staffer to see.

I began this practice of tracking client

**If you don't have explicit records, you probably aren't happy with the results. Worse yet, you don't know why things are not working.**

activity and revenue generation in 1985, shortly after I started in the financial planning business. In three short years, I had a significant amount of data, and I could see the business generated by my regular training and my meetings with prospects.

Additionally, I could see when my activity was going to pay off – that is, how long it would take to get me from the first meeting to cash flow, and what each meeting's probability of success would be. Initially, I found, it took eight to 12 weeks to start making money because I was mostly selling commissioned products. (This was the '80s, before the fee-only business really took hold).

As my revenue increased, I saw I needed support. By 1989, I was a boss with accountability to other people in the firm, including employees who expected a steady flow of revenue and work. Sharing with the staff how I tracked my hours and my success in winning new business became a natural

## Tracking client meetings

I found that 50% of my time at work was devoted to relationship building, and it paid off in numerous ways.

Month	Average weekly meetings
January	11.4
February	17
March	12.3
April	18.4

extension of my self-accounting.

I wasn't asking staffers to hold me accountable. Rather, I wanted them to know I was accounting for my actions. I also wanted them to know that whatever they could do to move prospects to clients, and then serve their needs effectively, was important because I paid attention to those numbers. They did, too. Those numbers became a powerful motivator.

## COMMIT TO CONTINUITY

I recommend you start tracking your client/prospect-facing activities, along with your training in that area. Keep very detailed records. If you're already collecting this

information, expand your data set and figure out precisely what your activities are doing for you. If you can't, get help from a coach or experienced advisor who knows how to keep score. Then share your activity with everyone who can help you move your business forward.

Many years ago, a 31-year-old self-made millionaire told me, "The commitment to continuity builds emotional stability." Put another way, being held accountable for your work is the cornerstone to a productive and emotionally stable life.

Napoleon Hill, in his book "Keys to Success: The 17 Principles of Personal Achievement," stated one of these keys was to employ self-discipline. "Self-discipline is the process that ties all efforts together for you," he wrote. "The power of the will trained by self-discipline is an irresistible force."

## BUILD YOUR SKILLS

All of this is well and good, but how do you know you're doing enough of the right things? Think of your career as like taking a long-distance road trip. One tank of gas won't be enough to get you to your destination. You must stop, refill your tank and make sure you're on the right road.

In a similar fashion, for the success of your decades-long professional career, you must get repeated training in both business development and the technical skills necessary to serve clients. That's refilling the tank. You also must regularly review your work efforts and resulting outcomes to make sure you're hitting your goals. That's making sure you're on the right road.

Simply reviewing your numbers and doing nothing about them isn't holding yourself accountable. Imagine you're in your car. That would be like knowing you've made a wrong turn but doing nothing about it. That wouldn't make sense, would it?

Persistent and consistent accountability is a fundamental requirement for success at every level of your career and your life. You ask for it from your clients every day. It's time you demand it from yourself. You'll be amazed at the results. **FP**

**Simply reviewing your numbers and doing nothing about them isn't holding yourself accountable.**

## SEC Warns RIAs to Think Twice

OCIE puts advisors on notice about widespread use of misleading claims and failures of disclosure.

BY KENNETH CORBIN

**ADVISORS NEED TO TAKE A HARD LOOK AT THEIR** marketing materials to ensure that they are not making misleading statements that could run afoul of the SEC's Advertising Rule, the commission is warning.

The SEC has been taking a close look at the statements and representations advisors make in their marketing programs. It has released a risk alert identifying a number of deficiencies the Office of Compliance Inspections and Examinations found in the course of more than 1,000 practice exams.

### A HARD LOOK

Firms need to watch for these risk alerts as they amount to the commission putting down a marker on a certain policy area. The alerts could indicate that examiners will take a hard look at those issues when they visit a firm, compliance experts say.

"It should be taken seriously since many, if not most, communications by advisors to clients or prospective clients will be deemed to be advertising," says Duane Thompson, senior policy analyst at Fi360, a fiduciary training firm.

"It really sounds like the SEC is saying investment fiduciaries need to step up their game given all of the slop that's evidently out there," he says.

The commission says as much in its risk alert, cautioning advisors to "review their compliance programs and practices in light of the topics noted in this risk alert."

What deficiencies did the SEC find?

**Misleading performance results:** The commission found that some firms' promotional materials were painting a misleading picture about the possible returns for investors. Some firms touted performance results but neglected to subtract advisory fees.



BLOOMBERG NEWS

Others omitted crucial disclosures that provide context to measures like benchmark comparisons.

### RELEVANT DISCLOSURES

**Misleading one-on-one presentations:** In some circumstances, the commission offers a carve-out to the Advertising Rule in the form of one-on-one presentations, which are seen as customized promotional pitches for an individual audience, as opposed to a brochure or radio ad intended to go widely.

But the OCIE examiners found that advisors failed to make relevant disclosures in those pitches about fees and performance results.

**Misleading claim of compliance with voluntary performance standards:** The commission was unable to verify the claims of many firms that they adhere to voluntary industry codes of conduct such as the Global Investment Perfor-

### View the Risk Alert:

OCIE found many compliance deficiencies when reviewing more than 1,000 practice examinations. See for yourself at <http://bit.ly/2IQy5Hb>



mance Standards. In 2014, the SEC barred the principal of an RIA for fraud and negligent representations surrounding the firm's claims of GIPS compliance.

### **Cherry-picked profitable stock**

**selections:** OCIE examiners found cases of firms only touting successful stock or product selections in materials such as their websites or client newsletters, likely amounting to a violation of the Advertising Rule.

### **INCOMPLETE PICTURE**

#### **Misleading selection of recommendations:**

Examiners found advisors who appeared to highlight certain prior investment recommendations that fared well, while neglect-



"It really sounds like the SEC is saying investment fiduciaries need to step up their game given all of the slop that's evidently out there," says Duane Thompson of Fi360.

ing to mention others, creating a rosy but incomplete picture of certain investment strategies.

#### **Compliance policies and procedures:**

## **Readers weigh in:**

"There must be extraordinary caution on the material published and promoted by BDs, as any misrepresentation is sure to be repeated by the broker."

Posted by

s.winks@SrConsultant.com

Perhaps not surprisingly, given the numerous deficiencies that examiners found, they also determined that many firms lacked adequate compliance programs to oversee

firms' advertising programs.

In particular, OCIE examiners cited firms for failing to sufficiently vet advertising materials and how they determined performance calculations. Firms were also cited for how they confirmed the accuracy of performance results to meet the standards of the Advertising Rule.

**Misleading use of third-party rankings or awards:** From a targeted 2016 exam sweep known as the Touting Initiative, where OCIE reviewed how firms were applying industry accolades, examiners found a litany of issues involving disclosures and misleading representations.

For instance, OCIE examiners found that some advisors appeared to have applied for industry accolades using false information, while other advisors advertised years-old industry rankings or promoted prohibited client testimonials.

### **'APPROPRIATE BENCHMARKS'**

Taken together, the issues highlighted by the risk alert suggest that advisors have a lot of work to do to get their advertising operations in order. Advisors should start with scrubbing their marketing materials to remove any of the potentially misleading claims that examiners will be looking for.

"I think this means, especially when it comes to investment performance, advisors need to be especially careful in making sure they are using the appropriate benchmarks and in terms of using social media," Thompson says.

"Although the SEC has eased up slightly on client testimonials, the basic restrictions are still in place," Thompson adds. **FP**

**Advisors should start with scrubbing their marketing materials to remove any of the potentially misleading claims that examiners will be looking for.**

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**Kenneth Corbin** is a *Financial Planning* contributing writer in Boston and Washington. Follow him on Twitter at @kecorb.

# HIGH NET WORTH

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## Avoid Nasty Estate Tax Surprises

Regardless of whether there's a tax overhaul, planners should help clients navigate complex transactions to ensure risk is mitigated.

BY MARTIN M. SHENKMAN

### HOW CAN ADVISORS HELP WEALTHY CLIENTS

lessen their tax risk when it comes to some complex estate planning strategies?

The estate tax exemption (prior to the Republican tax proposal) is \$5.49 million or \$10.98 million for a married couple (\$5.6 million or \$11.2 million for a couple in 2018). The exemption may increase or be repealed; stay tuned.

Does this mean planners no longer need to study complex estate planning mechanisms for their wealthier clientele? Not a chance.

Clients looking to move assets out of their ownership to avoid future estate tax costs, achieve asset protection benefits or meet other objectives still need to use sophisticated planning techniques. There has also been little talk in Washington of a gift tax repeal, so that tax is likely to remain for the foreseeable future.

### UNDERSTAND AND COORDINATE

Until estate tax repeal becomes a reality, planners should grasp the basics of complex estate planning transactions, and coordinate with other experts to ensure tax risk is mitigated as much as possible.

Consider, as an example, clients who own 100% of the stock in a family business worth \$20 million. The clients wish to gift \$5 million to a trust for their daughter, who is running the business. The clients could simply gift 25% of the stock to a trust for her.

However, if the IRS determines on a tax audit that the stock was worth \$40 million, not \$20 million, the value of the gift would be doubled and the client might owe gift tax at a 40% rate on the excess value. That \$2 million unintended gift tax would not be a pleasant surprise for your clients.

### AVOIDING UNINTENDED TAX COSTS

How can this potentially be avoided? Enter valuation adjustment techniques. These are strategies that attempt to assure



that, when a taxpayer transfers an interest in an asset that is hard to value, an unintended tax cost is not incurred.

Adjustment mechanisms that minimize the potential for an adverse tax consequence can be used in several planning scenarios, including:

- A client is making a large gift of an interest in real estate or an entity owning real estate.
- A client wishes to shift the value of a large interest in a business that is not publicly traded to a trust by selling it to that trust for a note.
- A nonmarketable asset is held in a trust and a client wants to swap cash or marketable securities they have into the trust in exchange for that asset, e.g. stock in a closely held business. An advisor might help a client do this so the stock is included in the client's estate when they die, thereby obtaining a step-up income tax basis on death (which can eliminate all capital gains), or perhaps because the client wishes to gift the stock to a different family member than the trust provided.

Advisors should be wary of one approach used to avoid an unintended tax cost: a reversion to the donor. This

approach does not work.

Using this mechanism, clients would gift or sell assets to a trust or their children. However, if the IRS determines the value is greater than originally intended, they would get that excess property back. The courts have viewed this as creating a "condition subsequent" and see it as a violation of public policy.

If the IRS attempts to enforce the tax law, this mechanism renders the issue the IRS challenged irrelevant. This is because the audit itself would shift the excess value back to the transferor.

### PRICE ADJUSTMENT CLAUSE

The price adjustment clause is another strategy that may be more successful. This method doesn't bring the property back to the client as the transferor.

Instead, it provides that, if the IRS determines the value is higher for gift tax purposes, the trust receiving the gift or buying the asset from the client would pay the difference back to them (or give a note) with interest from the effective transfer date.

### 'WANDRY' METHOD

Another approach, called the Wandry method, has been recognized by one court and is relatively simple to understand and implement. It may be best used for smaller and simpler transactions, but not all advisors are comfortable with it.

With this approach the client can make a gift, or sell an asset, based on a specified dollar amount. The dollar figure is fixed, but the number of shares actually sold may be adjusted if the IRS determines the value of those shares to be higher than the appraised value used in estimating the sale.

### BETTER APPROACH

Using a defined value mechanism is perhaps the approach that most estate planners believe has the greatest likelihood of success because several court cases have approved variations of it. But this approach presents

costs and complications.

In this approach, the client would part with all interests in the assets involved, regardless of value.

Assume the client owns 100 shares of stock in XYZ Inc., a family business worth \$100 million. The client wants to transfer \$20 million or 20% of the stock.

The client agrees, no matter what, to part with any right to 20% of the shares he believes should be valued (based on an independent appraisal) at \$20 million. The client sells those interests to a trust he has created for a promissory note with \$20 million.

If the IRS determines the value is not \$20 million but rather \$30 million, the client does not receive anything back; he has given up full control of the shares involved. How can the client avoid the gift tax if such an audit occurs?

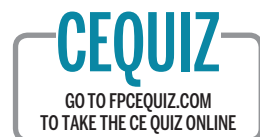
### NEGATING THE ASSESSMENT

The excess value of \$10 million in shares is transferred by contract to a different entity than the trust consummating the purchase from the client. That other entity is one that will negate the assessment of a gift tax. The most common entities used in this type of plan are:

- A charity (no gift tax as the value qualifies for the unlimited gift tax charitable contribution deduction). This entity is the preferable approach but not all clients will accept it.
- A marital trust (no gift tax as the value qualifies for the unlimited gift tax marital contribution deduction).
- A grantor retained annuity trust which by its structure can reduce the gift tax to zero or near zero as a result of an annuity payment back to the client.

Large and complex estate planning transactions are vitally important to the security and goals of many wealthy clients. Advisors can show their value during uncertain times by using mechanisms to help these clients avoid nasty tax surprises when these planning strategies are used. **FP**

**Advisors should be wary of one approach used to avoid an unintended tax cost: a reversion to the donor. This approach does not work.**



Martin M. Shenkman, CPA, PFS, JD, is a *Financial Planning* contributing writer and an estate planner in Fort Lee, New Jersey. He is founder of Shenkman Law. Follow him on Twitter at @martinshenkman.

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**6 PREDICTIONS**

# SURVEY

CRM / ROBO / RISK /  
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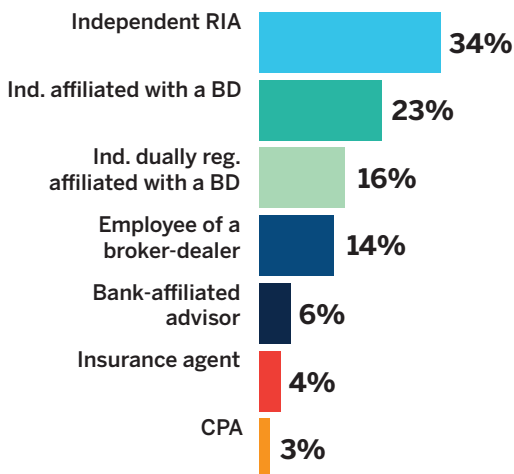
To compete with the robo invasion, advisors are finding technology that makes them more efficient and helps them deliver deeper insights and better advice.

BY HARRY TERRIS

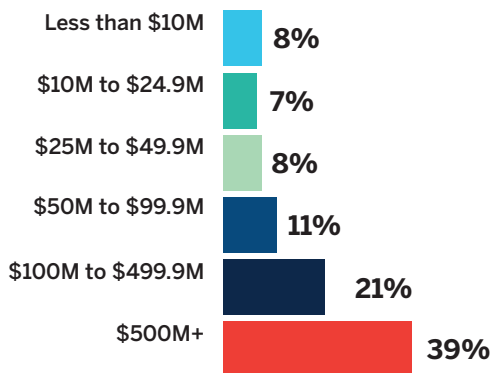
HOW TECH HELPED ONE  
ADVISOR FIND CLIENTS  
DURING CALI WILDFIRES

**FOR 2018** WHY TECH  
MATTERS  
EVEN MORE

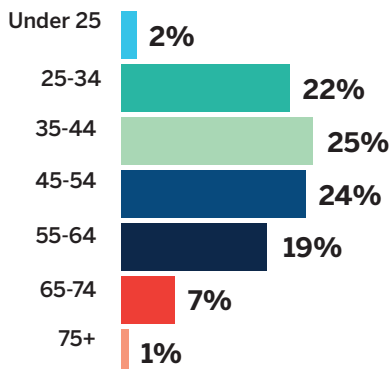
### Role/Firm Affiliation



### Firm AUM



### Respondent Age



Despite fears of a tech-led revolution, automated advice and natural-language artificial intelligence are not yet ready to eclipse traditional advisors. Indeed, they may never be ready.

Instead, these tech innovations are actually helping advisors. Major advances across the financial planner’s toolkit are making these tools more efficient. Vast improvements also allow advisors to build broader and deeper relationships with clients, and justify their fees.

“We recently purchased Social Security analysis software [that] is very robust and goes much deeper into planning around when to take

responses when we asked about the technologies advisors believe will change the wealth management industry over the next one to three years.

Automated advice platforms jumped to near the top of their list, and artificial intelligence and virtual reality figured prominently.

Then there was a surprising split. Smaller practices – those that have less than \$100 million in assets under management – put behavioral finance and advanced risk-profiling software higher in their ranking of transformative technologies than did their larger peers.

While wealth management firms of all sizes are trying to streamline their operations to benefit clients –

### SMALLER PRACTICES RANKED BEHAVIORAL FINANCE AND ADVANCED RISK-PROFILING SOFTWARE HIGHER AS TRANSFORMATIVE TECHNOLOGIES THAN THEIR LARGER PEERS.

Social Security,” says one advisor at a national RIA, a respondent in this year’s exclusive *Financial Planning* Tech Survey. “It’s not cheap, but has helped us close \$15 million in business over the last year.”

### THE POWER TO TRANSFORM

So which technologies offer the most promise? Which have the most power to be transformative?

In our study of roughly 1,000 advisors – from independent RIAs to planners affiliated with a broker-dealer to other types of advisors – we learned some surprising and counterintuitive ideas about the tools of the present and the future. Together, they provide a road map for the years to come.

We were struck by the

mobile is a prime example – smaller firms especially are focused on ways to enhance the human element and provide smarter, better and more sophisticated advice.

Risk-profiling software “changed the way we talk to clients about risk, and enabled better conversations,” says an advisor at an RIA firm.

And while many advisors are not focused on the mass-market business for which robo advice is designed, they are reporting tech success in other areas.

Rolling out technologies that achieve incremental but meaningful improvements in client platforms and presentations is one.

Additionally, better technology is helping advisors win clients’ confidence that their data and

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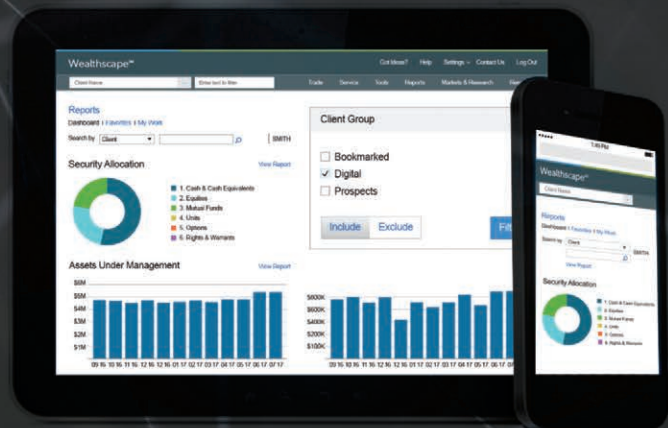
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**ROBO TRANSFORMATION**

Among advisors at large firms – those with more than \$500 million in assets under management – 44% say that robo advice is poised to transform wealth management in the next few years, nearly tied with the most popular choice, mobile apps (and greater than the total who believe.

Those who have deployed robo solutions say it has helped them reach younger clients with low-balance accounts.

Schwab’s offering “is useful with small accounts that we don’t want to manage,” says an advisor at a dually registered RIA affiliated with a broker-dealer.

**HAVE IT, DON’T USE IT**

Overall deployment is low so far, however, with only 23% of advisors at large firms reporting they use robo tools. Among firms of all sizes, just 18% of advisors says they’ve adopted a robo solution.

At small practices, 41% of advisors say behavioral finance software is set to change the industry, making it their top choice. Advisors at small firms are also more likely to describe advanced risk-profiling software as transformative – 21% do, compared with 18% at large firms.

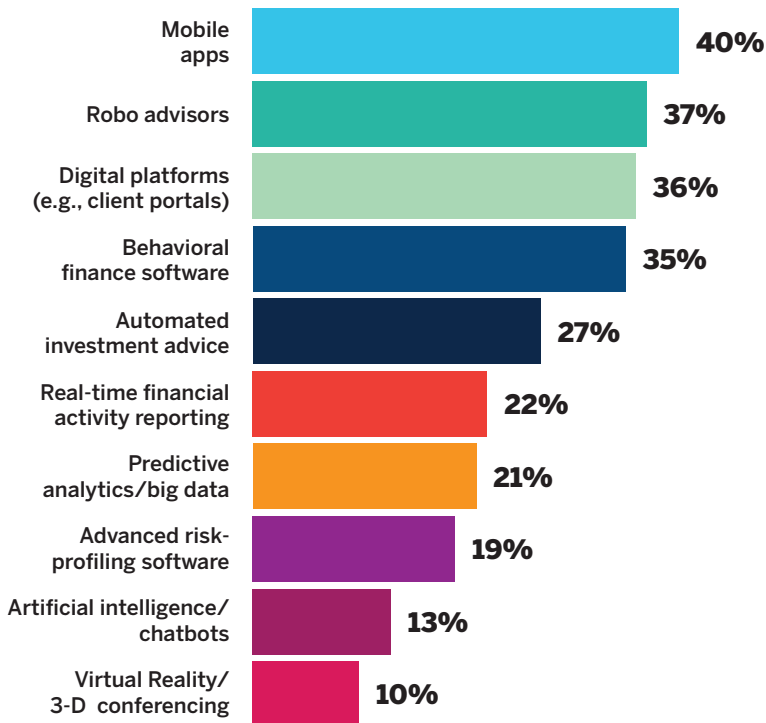
**ABSORBING LOSSES**

Advisors who report success launching risk-profiling technology say that it has been instrumental in helping clients discover their ability to absorb losses – or take on risk to pursue higher gains.

These programs also can explain which investments fit a client’s profile, and then design appropriate portfolios for these clients.

“It has been fun to watch the light-bulb come on when we’ve talked about how you shouldn’t gauge your

**Tech That Will Change Wealth Management**



portfolio’s performance based on what the S&P 500 is doing unless you are investing at the risk level of

at a dually registered RIA affiliated with a broker-dealer.

Among midsize firms – those

SOME FIRMS THAT HAVE DEPLOYED ROBO TECHNOLOGY SAY IT “IS USEFUL WITH SMALL ACCOUNTS THAT WE DON’T WANT TO MANAGE,” IN THE WORDS OF AN ADVISOR AT A DUALLY REGISTERED RIA.

the S&P 500,” says one planner at a national RIA. “It has really helped us to manage clients’ expectations.”

Other advisors say risk-profiling software has given them a competitive edge. For one, it allows them to “bring new prospects under management due to misaligned investments with other brokers,” says an advisor

with \$100 million to \$500 million under management – client portals are seen as the most dynamic technological component.

About 44% of advisors in this group say advancements in the way they interact with clients will change the industry in the next few years, citing back-office efficiencies, up-to-date reports, secure





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communications and differentiation with competitors that rely on paper.

These new portal systems have “removed the wall between client and advisor when it comes to knowledge of their financial position,” says an advisor at a national RIA.

Advisors also told *Financial Planning* they have been able to tap into new client assets through account aggregation features.

**RECRUITING OUTLOOK**

Robust technology has helped many firms attract talented staff by enabling them to build strong books of business. Indeed, some technology has the potential to change the entire landscape of recruiting and hiring.

Respondents say that introducing behavioral finance software, automated investment advice and real-time financial activity reporting are most likely to impact recruiting and hiring at their firms.

Sophisticated technology also allows back-office planners to “create holistic financial plans for our clients” and engage in a genuinely collaborative process, another advisor with a dually registered RIA affiliated

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with a broker-dealer says.

**NOT A BRIDGE TOO FAR**

And while robo advice and artificial intelligence may seem like a bridge too far for some planning practices, many advisors say they have made major strides by improving fundamental technology, including customer relationship management and financial planning software.

Compared with technologies further out on the frontier, respondents score both of these systems favorably in terms of ease of integration and ease of learning how to use them — key considerations in deciding which technology to adopt.

Moreover, putting basic building

blocks in place can be just the beginning of a digital transformation.

One advisor at an RIA affiliated with a broker-dealer says the transition to a new CRM system took a lengthy process of acculturation, but “now that we’ve been doing it for a few years, our advanced analytics group has developed some impressive models for sales and service interventions.”

When it comes to recommendations, tech decision-makers are skewing younger. In 2017, 25.5% of those who influenced which tools to purchase were 25 to 34, and 37.1% of them were 35 to 44.

When actually making the final decision, 6.8% of those who ruled on purchases were 25 to 34, and 21.5% were 35 to 44.

It could be that certain generations are more comfortable working with digital tools, allowing for greater innovation and efficiencies.

“We recently purchased Redtail Imaging to fully go paperless,” one advisor says. “This has led to far less copying, printing and wasted time. We can easily share access with clients also.”

The tools are there. Let’s see if adoption continues. **FP**

Harry Terris is a *Financial Planning* contributing writer in New York. He is also a contributing writer and former data editor of *American Banker*. Follow him on Twitter at @harryterris.

**Top Technologies That Will Impact Advisors**



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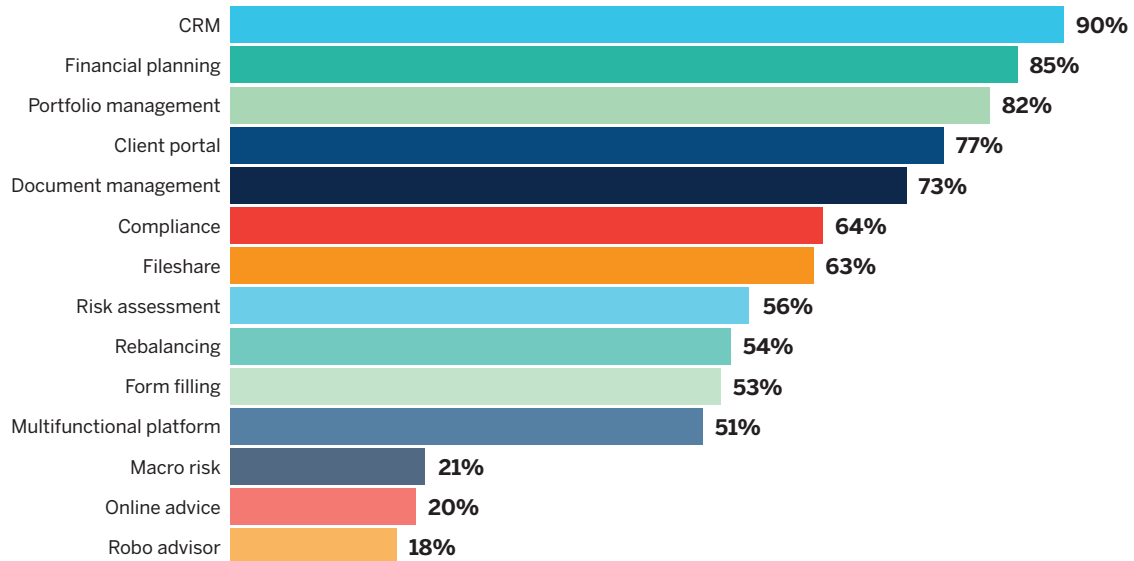
<sup>1</sup>Nationwide as of May 2016. Based on an individual with full retirement age of 66, comparing early filing at age 62 and receiving reduced benefits of 75% of primary insurance amount versus delayed filing at age 70 and receiving credits to increase benefits by 32% of primary insurance amount.

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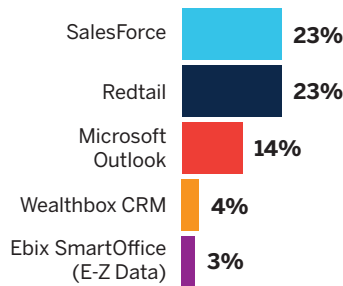
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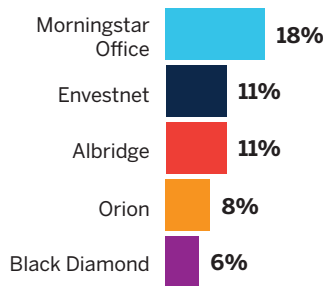
### Tools Used by Advisors



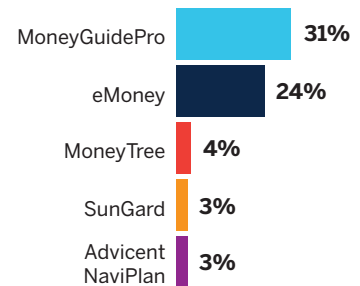
#### CRM



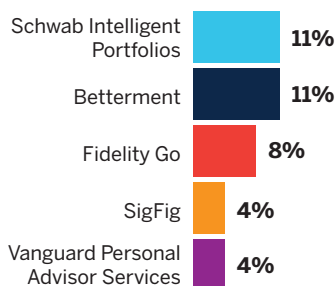
#### Portfolio Management



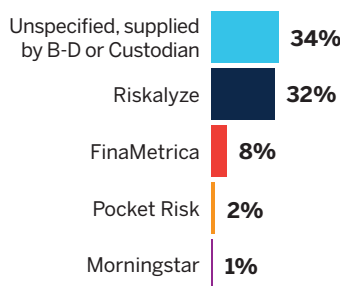
#### Financial Planning



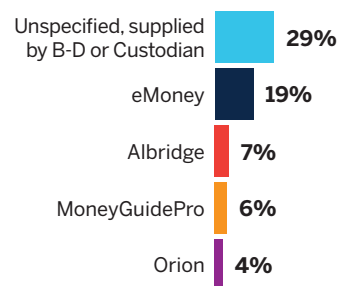
#### Robo Solution



#### Risk Assessment



#### Client Portal



# New Tech Success Stories

We asked advisors to tell us the good and bad about their technology solutions. Here's what they said.

## The Good ...

- We were able to switch to a web-based phone, fax and document management system, which saved us time and money and increased our mobility.
- We went from sharing files over the cloud to a physical file server with a mobile client. We are able to keep reliable track of client files in the office, back them up to a third-party cloud and access the files in a secure way. It adds a layer of convenience, and also gives the appearance of constant readiness to our clients.
- We recently updated our client portal to be more user friendly and robust, and we get great feedback from it.
- We recently implemented a streamlined insurance platform that has been generating lots of new busi-

ness due to ease of processing applications.

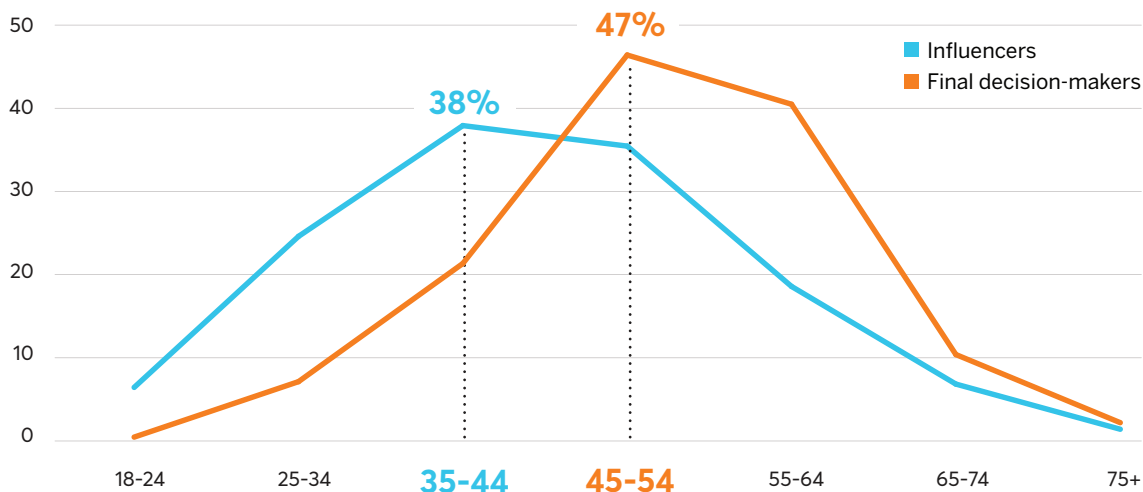
- We purchased bond market analytic software, which enhanced our ability to manage client accounts.
- We have recently upgraded one of the software packages in our system. The technology was up-to-date and easy to use. Most important, the technology helped improve our workflow and made our processes more efficient, and so increased our sales revenues.
- We have recently added the capability for clients to upload documents directly online. This has cut down dramatically on the time workflows take to be finished.
- We have a portal that simulates the pre-client experience of what it'd look like if they were to come on board. People really enjoy taking

things for a "test drive" before committing.

## ... And the Not so Good

- I wish I could share a success story, but of all of the changes in the last three years, I don't think any of them have been particularly beneficial, just more of the same.
- We are using all old tech!
- We are still waiting for something worth telling; so far, we've only maintained ourselves in line with our competition.
- I do not have a success story. Technology is a necessary evil and integrating the various platforms is a major pain. A single robust solution would save us a lot of time and money.
- There are no recent purchases. But a purchase is desperately needed.

## Ages of Technology Influencers and Decision-Makers



# 6 Tech Predictions for 2018

Which innovations and tools will have the biggest impact on advisory practices in the year ahead?

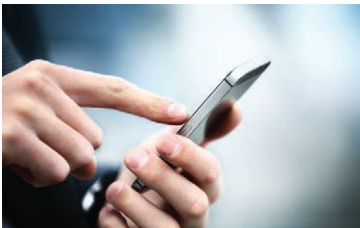
BY SULEMAN DIN

**IT'S ALMOST 2018, AND YOUR CLIENTS ARE STARTING** to wonder why their finances aren't just as accessible as an Uber car or a shoutout to Alexa. Get ready for the latest innovations in mobile, artificial intelligence and microinvesting to make a big leap from the periphery into the heart of advisor practices.

Here are our predictions for the trends and tools that will have a significant impact over the coming year.

## EVERYTHING MOBILE

Watch for more financial planning practices to migrate to mobile. Advisors able to deliver a slick and consistent experience on an app will have an edge over those who cannot. Advisors may also increasingly find themselves communicating with clients via text messages. Response rates are much higher when you use text as opposed to email – just make sure your texts are fully compliant.



## VIRTUAL ASSISTANTS

"Alexa! Bill my clients." Only a few years ago, artificial intelligence was still in the realm of science fiction. No more. Now even the most established RIAs are beginning to see how virtual assistants and machine learning can be built into their back-office operations. Banks are also experimenting with virtual assistants to automate tasks and aid service reps on calls with clients.

Tech companies including Amazon are providing tools at an enterprise level, and there will be a trickle-down effect. Expect to



see a growth of new virtual tools for advisors to help with paperwork, scheduling and even client interaction.

Don't worry, though, about AI-driven client-facing support; It will still be some time before a bot can answer complex advice problems.

## INSTANT PORTFOLIO RECOMMENDATIONS

Tech tool providers have long touted the ways that they streamline the financial planning business, but serving up thoughtful portfolio strategy recommendations still takes time: first, submit a request for an analyst, then wait for a report back.

Fund companies eager to develop themselves as advisor service providers are now offering platforms with alternative strategies that are accessible in a couple of clicks.

This service is not a substitute for speaking with an analyst, but the option drastically reduces the time that it takes to have a report in hand.



### PROVIDER CROSSOVER

When is a big finan-

are wandering into the RIA sandbox, sensing the market opportunity to serve the breakaway advisor movement. Look for greater experimentation in offerings, which means advisors will increasingly be pitched all-in-one platform solutions.

It could also mean that independent brand you've been utilizing for years will suddenly get swallowed by the corporation you avoided because you weren't sure about the level of personalized service.

### HYBRID EXPANSION

If 2017 was the year the big wealth management firms claimed asset dominance in the digital advice space, 2018 will be the year that firms of all sizes equip themselves with platforms allowing for centralized service of clients across the country.

It's also worth watching how the biggest firms nurture CFP talent to staff ever-growing call centers. Not only will such developments provide an aging industry a shot of youth, it will also present RIAs with opportunities to recruit young CFPs with a deeper background of practical experience — and at very reasonable salaries to boot.

### MICROINVESTING

If you haven't been paying attention to the microinvesting apps Acorns and Stash, you should start in 2018.

Bigger firms may talk a good game about attracting young investors, but it's microinvesting tools such as these that have made real inroads into the millennial market.

Stash, for instance, has more than 1 million subscribers and is growing at a rate of 25,000 subscribers a month, the firm says. Of course, the assets aren't there yet, but these firms are aggressively working to ensure their young clients grow into wealth and stay with them.

These apps are also coming up with new methods to serve clients, offering such features as banking and student loan debt management. They may be onto something. **FP**



cial planning software firm also a white-label hybrid platform provider? Or a giant asset manager a source of tech tools for independent advisors?



That time has come: technology providers of all stripes

Suleman Din is technology editor of *Financial Planning*. Follow him on Twitter at @sulemandn.



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# PRACTICE

ALSO IN PRACTICE: P. 46: Should I ... Focus on a Niche?

## The Young Shall Lead

Here's a different client acquisition sequence: Step 1. Attract Generation X and Generation Y clients. Step 2. Reach their baby boomer parents.

BY NINA O'NEAL

**WHILE FINANCIAL ADVISORS SCRAMBLE TO ATTRACT** millennials, our firm is trying a different approach: We're forming strong relationships with our youngest clients to ultimately reach their baby boomer parents.

This client acquisition strategy has been long in the works and was informed by my own experience navigating my early days in the financial services industry.

When I was a trainee in my 20s at a large wirehouse, I had to abide by certain household minimums for engaging new clients. During my time there, I was frequently frustrated by the asset minimum requirement, as it often excluded younger investors.

In fact, my age-group peers did not always meet that requirement – but they were still reaching out to me for advice and investment management. Many of these friends were young professionals who had great future earnings and wealth potential.

### A NEW MODEL

When I joined my partner at our current firm in 2009, these experiences prompted us to create a business model that accommodated lower assets per household and provided advice and guidance for younger clients.

Several years ago, our firm was referred to a young couple with two small children who needed financial planning services, college savings tools, a couple of small rollovers and life insurance. At this point in their lives, their savings were mostly in the wife's corporate retirement plan.

It was an easy process, and I was delighted to provide advice for an investor my age. As a busy young professional with children myself, I appreciate being able to outsource anything that is not in my area of expertise, so that I can focus time on my family and work. My Gen X and Y peers are no different. We continue to strive to create an easy, engaging client experience and to provide them advice as they make life transitions.

A few months after we began working with the young



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couple, I received an email from the wife. Her parents were moving to the area to be closer to their grandchildren, and they were looking for a local advisor. She was adamant that her parents meet with us and consider our firm.

This was an aha moment for me: Gen X and Gen Y have baby boomer parents. And many of them are newly relocated retirees in the market for a new advisor. For the last several years, we've continued to see the same pattern repeating over and over again. Gen X and Y children are bringing their parents, and sometimes even their grandparents, to us as clients.

### CHILDREN FIRST, PARENTS NEXT

In building multigenerational practices, we as advisors are constantly being told to go for the next generation. This message is true – after all, millennials are expected to inherit \$30 trillion of U.S. wealth. But it also overlooks the opportunity to create relationships with the older generations, by gaining their children as clients first.

Attracting Gen X and Gen Y clients will not be accomplished simply by adding a robo option to your website: Gen

X and Gen Y are sophisticated consumers. We also find them to be loyal, trusting and grateful for good advice and customer service.

And don't be fooled, these generations do have assets and a need for sound financial advice as they make big life transitions, both personally and professionally.

### LIFE CHANGES FOR PARENTS

These clients are also seeing their parents experience major life changes such as retiring, relocating, downsizing and dealing with health challenges and long-term care concerns, just to name a few.

Gen X and Y clients have an influential voice with their parents, who will soon need help managing their financial affairs. Asking clients probing questions about their parents' financial plans can create an opportunity for a referral.

In many cases, the two generations want to work together with the same firm, but they may find it difficult to identify an advisor that both parties want to work with.

### ACHIEVING A BALANCE

I've come to realize that achieving this balance is easier than it seems. While millennials may be more technology-

savvy than their parents, both generations are looking for the same thing: genuine advice from a relatable and trustworthy professional who pays close mind to their financial goals, needs and desires.

Millennials aren't the elusive white whale that the financial advice industry has made them out to be. In fact, they're just looking for the same face-to-face advice that previous generations have appreciated.

Advisors are fully capable of providing that excellent advice to Gen X and Y clients, and should harness those relationships to go upstream and reach the older generation. **FP**

Nina O'Neal is an investment advisor and partner at Archer Investment Management in Raleigh, North Carolina. She focuses on planning for high-income professionals, women and business owners. Follow her on Twitter at @noneal510.

## Should I ... Focus on a Niche?

If you are versed in a genuine specialty, it can be a great way to stand out from the rest of the pack. But it also narrows your potential client universe.

BY INGRID CASE

**CREATING A NICHE MARKET FOR YOUR PLANNING** services can be an opportunity to stand out in a crowded field of advisors.

When Individual Asset Management founder Tom Zachystal turned his focus more internationally, he found his target audience. At his planning firm in Menlo Park, California, 90% of the clients have something big in common: they are either Americans living abroad or foreign citizens living in the United States.

"We specialize in cross-border issues, which is kind of unusual, so clients seek us out," Zachystal says.

They often find him while looking for solutions to problems that flow from United States tax laws. "U.S. citizens

who live overseas have a U.S. tax-reporting burden, and then their brokerage firms do as well, so both local and U.S. brokerage firms shy away from them," Zachystal says.

Expats often have tax quandaries as well as problems with estate planning, moving money among nations, get-

ting bank accounts and debit cards and wiring funds.

He solves the problem by using custodial firms to hold client accounts and finding discount brokerage firms that will accept their business.

"The key is to have a network of professionals in different countries and areas of

expertise," he says, because a planner can't possibly be an expert on every country's cross-border policies.

### Pivoting to a Niche Practice

Factors to consider before specializing. Do you:

1. Bring a deep well of knowledge?
2. Expect to grow slowly?
3. Understand that some prospects will go elsewhere?
4. Take comfort from the fact that you likely will attract at least some clients who are the right fit from the start?

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A niche practice might be right for you, too, if you can develop a genuine specialty.

"Is there anything really different about helping dentists, as opposed to helping physicians?" Zachystal asks. "Not really. You should bring some kind of specific qualifications or knowledge. That's what's valuable."

### **SLOW AND STEADY**

A word of warning is in order: A practice that is designed to serve a particular niche from the very beginning may take awhile to get off the ground.



Melissa Ellis, founder of Sapphire Wealth Planning in Overland Park, Kansas, gradually specialized in working with divorced women who need college planning services for their children.

"It was difficult to get the practice going," Zachystal says. "I can't meet most of my clients in person, so they can't see our offices. There are many weird things going on in unregulated financial markets, so expats of many years tend to be cautious. It took 10 years for my name to really get around the expat community."

Converting a general practice over to niche is often easier, according to those who have done it. Melissa Ellis, founder of Sap-

phire Wealth Planning in Overland Park, Kansas, made the conversion gradually.

"My client base was mostly women in their 30s, 40s and 50s, and college planning and divorce were the issues they were dealing with," she says.

"I was divorced myself at the time and had kids in high school and college, and as I learned about my own situation, I realized that there are a lot of issues around college planning when the parents are divorced."

Bit by bit, Ellis began to specialize in working with divorced women who are faced with college planning needs for their children. She maintains general clients, but new additions tend to seek her out for her specialty. Of course, some dismiss her as a potential planner because of her specialty, and Ellis accepts that.

"I don't want to be all things to all people," she explains. "Some people will look at my website and say, 'That's not me.' But I also attract the people who are right for me."

### **DRIVEN BY CHARITY**

Personal interests also got Patrick Renn into a niche practice. The founder and president of Renn Wealth Management, based in Atlanta, he became involved with the Special Olympics and over time gained board members and donors as clients.

That grew into a specialization in prosperous clients who are interested in and involved with substantial charitable giving.

"A lot of planners don't regularly talk with their clients about significant charitable giving," Renn says. "Either they're not familiar with the concepts or they aren't familiar with discussing it, because they don't feel expert enough. But clients want to talk about it."

Renn points out a great benefit in developing a niche as a planner. "In the public's eyes, there's a great sameness among advisors. Once you figure out what you can really get excited about, it's very freeing," he says. "You can focus on becoming the go-to person in that niche" — a powerful position for any planner.

**FP**

**Is helping dentists different from helping physicians? Not really. "You should bring some kind of specific qualifications or knowledge. That's what's valuable."**

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**Ingrid Case**, a *Financial Planning* contributing writer in Minneapolis, is a former senior editor for *Bloomberg Markets* magazine. Follow her on Twitter at @CaseIngrid.

# TECH ZONE

ALSO IN TECHZONE: P. 52: Therapy for Bad Client Behavior | P. 53: Too Much of a Good Thing

## The Problem With Innovation

New planning software offers plenty of features, but still lacks the focus to track a client's needs.

BY MICHAEL KITCES

**FEW PLANNING SOFTWARE COMPANIES HAVE** managed in the past decade to take on today's incumbents – MoneyGuidePro, eMoney Advisor and NaviPlan. The problem is the cost of switching is often very high for advisors, given that client data isn't portable and can't be effectively migrated from one solution to another.

More importantly, though, few new providers have really taken an innovative and differentiated vision of what planning software can and should be.

Consequently, there is tremendous opportunity for real invention. And with fiduciary regulations on the horizon, the landscape is ripe for smaller competitors to capture market share. Will the coming years usher in a new phase of innovation?

### EVOLUTION, NOT REVOLUTION

In the early days of planning, virtually no one was actually paid to deliver a financial plan. Instead, advisors were compensated by the planning products they implemented, i.e., insurance and investment solutions. Tools like Financial Profiles, founded in 1969, focused on retirement projections, which would demonstrate a need to save and invest more – putting dollars into the advisor's products.

By the '80s though, there was an emerging movement to actually get paid for their plans, not just push products. The challenge, however, is that to get paid for a financial plan, the

rigor of the planning analysis had to stand as a value unto itself.

Fortunately, the rise of the personal computer meant that advisors could buy more sophisticated analytical tools. Accordingly, 1990 saw the birth of EISI's NaviPlan, the first cash-flow-based planning software, which was substantively differentiated from its predecessors in its ability to model in-depth, long-term cash flow projections.

However, by modeling cash flows, it was necessary to input and project every cash flow. As a result, the time-consuming nature of

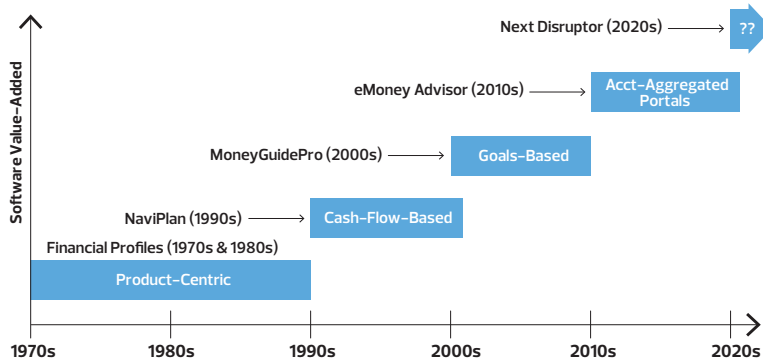
inputting data into cash-flow-based planning tools led to the advent of MoneyGuidePro in 2000 and the birth of goals-based planning software, where the only cash flows that had to be inputted were the specific saving inflows and spending outflows of the particular goal.

Yet the problem with goals-based

planning is once the plan is delivered, there isn't much else to do. As long as the client remains reasonably on track, each updated planning projection simply shows the same retirement and wealth trajectory as the last, with little change from year to year – let alone quarter-to-quarter.

Consequently, a new gap emerged for planning software that could actually show meaningful tracking on a more frequent basis. This opened the door for the rise of eMoney Advisor, which was also founded in 2000 but really gained traction in the 2010s as account aggregation tools like Mint.

### Progression of Differentiation in Planning Software



Source: Michael Kitces

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com made consumers and advisors increasingly aware of the value and virtue of continuously tracking and updating a household's entire net worth and cash flows. A Personal Financial Management dashboard would go beyond just their portfolios, or their progress toward ultra-long-term goals.

### **DISRUPTORS OF THE FUTURE**

The progression of financial planning software from a product-needs basis to a cash-flow basis to a goals basis, and then on to account aggregation, helps define when and why certain companies have grown over the past several decades, while others have languished. And because client data still isn't portable, changing solutions is a massive and potentially firm-breaking risk.

Only substantial differentiation that supported a fundamentally different financial advisor value proposition has attracted advisors away from competing solutions.

### **TAX-FOCUSED PLANNING**

Advisors can show clear value in today's environment through proactive income-tax planning strategies, as real-dollar tax savings can handily more than offset most or all of a comprehensive planning fee. Unfortunately, most planning software falls short when it comes to detailed income tax planning, especially with state income taxes.

A tax-focused planning software solution would project actual taxable income and deductions from year to year, with future tax brackets adjusting for inflation, and also include the impact of state income taxes. Too often, simple assumptions like an effective tax rate in retirement grossly miscalculate tax obligations over time, and utterly fail to represent the positive impact of prospective tax strategies. For instance, how can you possibly show the value of the backdoor Roth contribution strategy, or systematic partial Roth conversions in low income years, if the software always assumes the same static average tax rate in retirement and ignores the actual tax consequences of Roth conversions when they happen?

Simply put, tax planning has real value, and planners shouldn't be constrained to

standalone software tools like BNA Income Tax Planner, when it could – and should – be part of the holistic financial plan.

### **SPENDING PLANS**

Historically, advisors have focused their advice on investments and insurance, for the remarkably simple reason that that's how most advisors get paid – either for implementing such products and solutions or managing them on an ongoing basis. As a result that's where most planning software has focused. However, from the consumer perspective, the center of most people's financial lives is their household cash flow.

This is why Mint.com cash flow tracking tools grew to 10 million active users in its first five years – which would be almost 10% of all U.S. households – while the typical advisory firm struggles to get 20% to 30% of their clients to log into their noncash-flow-based planning portal once or twice a year.

And there's evidence that regular use of planning software to track spending matters. One recent study on Personal Capital's mobile PFM app found the average Personal Capital user cut their household spending by 15.7% in the first four months after using the mobile app to track their spending.

In today's world, most advisors don't work with clients on their cash flow because it's difficult to show value, and because it's challenging to get clients to track their spending in the first place. But as tools like Mint.com and Personal Capital have shown, software can effectively help solve both of these challenges.

### **THE NEXT GENERATION**

The majority of advisors are focused on baby boomer and silent generation clients, for that's where the money is. Yet the end result of this generational focus is that virtually all planning software tools are built for the needs of baby boomers with assets, particularly when it comes to retirement planning, while not a single planning software solution can effectively illustrate the core planning issues of Generation X and Generation Y clients, such as strategies to manage the nearly \$1.4 trillion of student loan debt.

**Because client data still isn't portable, changing solutions is a massive and potentially firm-breaking risk.**

Similarly, most planning software lacks other relevant tools for younger clients, like cash flow planning support, and helping to project the consequences of major career decisions.

Ironically, even as financial planning software has historically focused on baby boomer retirees, most tools do very little to illustrate actual retirement distribution planning strategies.

For instance, is it better to liquidate an IRA or a brokerage account first, or use the brokerage account while simultaneously doing partial Roth conversions? How can an advisor evaluate if a particular annuity product would be better for the client's plan, when no planning software can illustrate specific annuity products – and ditto for loan-based life insurance strategies for retirement income? Would the client be better off using a bucket strategy instead of a traditional total return portfolio?

Simply put, advisors provide a tremendous range of specific, implementable retirement strategies that have to be illustrated and explained in a piecemeal process outside of planning software, because today's tools aren't capable of illustrating what advisors actually do.

## A PAPERLESS FUTURE

Advisors have been going paperless and digital in recent years, aided in no small part by the explosion of digital onboarding tools. However, most of today's planning software is still built with a printed-report-first philosophy, rather than being created with a visually appealing on-screen interface that allows the advisor and client to collaboratively make changes on the spot.

Yet collaborative planning can both save time – avoiding the preparation of alternative scenarios that turn out to not even be relevant – and break down the fundamental flaw of goals-based planning, which is that most clients don't even know what

their goals are until they use planning software to explore the possibilities.

Similarly, the greatest blocking point for doing planning with most clients is that they don't even have the data to provide to the advisor to input into the software, and even if they do it is one of the most time-consuming steps of the process. A digital-first

planning software could be built to collaboratively gather the data modularly over time, helping to draw clients proactively into the process by showing them incremental value as the plan is created before their eyes.

## REAL, ACTUAL ONGOING PLANS

For planners who do ongoing com-

## Potential disruptive differentiators for the next gen of planning software



### REAL TAX-FOCUSED FINANCIAL PLANNING

Software capable of accurately modeling a wide range of tax planning strategies, including federal and state income taxes, from year-to-year timing of income and deductions, backdoor Roth strategies, systematic partial Roth conversions, RMD planning, and more.



### SPENDING AND CASH FLOW PLANNING

Tools that automatically track and categorize household cash flow, helping households to evaluate and manage their spending and saving... and tying those cash flows directly back to accumulating for various financial planning goals.



### PLANNING FOR GEN X AND GEN Y CLIENTS

Software that illustrates core issues to Gen X and Gen Y clients, including managing student loan debt, budgeting and cash flow support, major career decisions, and human capital planning more generally.



### TRUE RETIREMENT DISTRIBUTION PLANNING

Modeling for specific retirement liquidation strategies, including illustrating specific annuity products, bucketing strategies, asset location and partial Roth conversion strategies, dynamic spending adjustments, culminating in a Withdrawal Policy Statement for clients.



### COLLABORATIVE FINANCIAL PLANNING SOFTWARE (NO MORE PAPER REPORTS!)

Software designed to be used live, interactively, and collaboratively with clients, both to build and deliver the financial plan, to the point that no output ever needs to be (or is expected to) printed. The plan itself is entirely digital, and continuously updated by software.



### COMPREHENSIVE PLANNING SOFTWARE THAT ACTUALLY CREATES A COMPREHENSIVE WRITTEN PLAN

Software that can produce an entire financial plan, eliminating the need to collate together financial planning software output with separate Word and Excel documents and other supporting materials.



### ONGOING FINANCIAL PLANNING WITH OPPORTUNITY TRIGGERS

Software built for not just an initial financial plan, but an ongoing planning relationship, that both provides a historical roadmap of trends and a timeline of progress and success milestones, and uses account aggregation to not only continuously update the status of the plan, but trigger alerts to the advisor when a planning opportunity or issue arises.

Source: Michael Kitces

prehensive planning – most commonly as a planning-centric AUM fee, or an ongoing retainer fee – the bulk of the planning relationship is what happens in all the years after the first one, not the initial planning year.

Unfortunately though, no planning software is built to do effective ongoing planning, where the client's plan is a living blueprint – continuously updated via account aggregation and showing both progress toward goals over time and the progress of goals already achieved – which is crucial to validate the ongoing planning relationship.

If the planning software were continuously updated, at what point could it tell the advisor when there's an opportunity to engage the client, from important milestone birthdays (e.g., 59 ½, or age 70 ½), to changes

in adoption and usability.

The key point is that the true differentiator of planning software isn't a feature issue – it's a focus issue.

Advisors need a software solution with clear features that support a differentiated vision of the value of financial planning for a particular target clientele.

For instance, building truly tax-focused planning software means the tax tables need to permeate every part of the software – from the input to the analytical tools to providing output that shows tax benefits and tax savings. True retirement distribution software needs to invest heavily in integrations to bring in and accurately model all the various retirement products and strategies that exist today.

**Advisors need a software solution with clear features that support a differentiated vision of the value of financial planning for a particular target clientele.**

**15.7%**

The amount by which a user of Personal Capital's mobile app cut their household spending.

Source: Personal Capital

in client circumstances that the software detects, or even notifying the advisor that interest rates have fallen to the point that the client can refinance a mortgage?

In the end, planners shouldn't have to meet with clients regularly to see if there are any new planning needs, because ongoing planning software should be continuously monitoring the client's situation, and notifying the advisor of the planning opportunity.

#### **FINDING A FOCUS**

Sadly, most planning software companies will claim that they do most of the items listed on the previous page. Yet planners know in practice that most don't do (m)any of these things very well, forcing advisors to supplement financial plans with manually created output from Excel.

The financial planning software companies that usually do them end up with excessive feature bloat and the associated decline

#### **THE GOOD NEWS**

There are a number of opportunities for planning software newcomers to meaningfully differentiate – both as an opportunity for reinvention among the large, aforementioned incumbents, today's emerging players, and startups that are still building behind the scenes and haven't launched yet.

But at the same time, for the sake of new company growth – and the betterment of the planner community itself – it's time for planning software companies to take a bold step forward into the future, and not just building for how financial planning has been done in the past, up until today.

With the Labor Department's fiduciary rule as a catalyst, advisors and services institutions are being driven to shift from simply distributing products to truly getting paid for planning advice – which means the demand for planning software, including new solutions, should only grow from here. **FP**

**Michael Kitces**, CFP, a *Financial Planning* contributing writer, is a partner and director of wealth management for Pinnacle Advisory Group in Columbia, Maryland; co-founder of the XY Planning Network; and publisher of the planning blog Nerd's Eye View. Follow him on Twitter at @MichaelKitces.

## A New Skill Set for Advisors

Planners need to learn to identify clients' unconscious biases to be in a position to help them avoid certain financial choices.

BY SEAN ALLOCCA

**ADVISORS SPECIALIZE IN KNOWING EVERY FACET OF** their clients' financial lives. Will they need to delve into their mental processes and emotional states, as well?

Absolutely, says Dan Egan, Betterment's director of behavioral finance. With automated software digitizing many menial tasks – like rebalancing portfolios and using tax-loss harvesting – the advisors' value will hinge on dealing with complex human relationships, he says.

A foundation in behavioral finance could prove advantageous, Egan believes.

"That's a skill set that I would be investing in right now," he says, "so I could leverage technology, but also be able to add the necessary human element."

Betterment has already incorporated behavioral finance elements into its client platform, Egan says. For instance, the firm uses visual cues to show whether or not a client is doing enough to reach his goals. Betterment displays financial information in green when a client is meeting savings goals, but those same numbers show up in bright orange if not.

Egan, Victor Ricciardi and investment advisor Michael Pompian shared their thoughts on the subject of behavioral finance during a recent *Financial Planning* webinar.

### COGNITIVE VS. EMOTIONAL BIASES

Although advisors are becoming savvier to behavioral approaches, some just don't know where to start. Articles from the *Journal of Financial Planning* are a good resource, says Ricciardi, assistant professor of financial management at Goucher College in Baltimore.

There are two basic types of behavioral biases: cognitive and emotional, says Michael Pompian, founder and CIO of Sunpointe Investments.

Cognitive biases produce "followers" or "independents" depending on risk tolerance levels, while emotional biases



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lead to "preservers" or "accumulators." Advisors should moderate the portfolios of clients with cognitive biases and adapt to those with emotional biases, Pompian says.

Exhibiting overconfidence and trading too much, or losing risk tolerance, are some of the more obvious signs of a money disorder, Ricciardi says.

"Learn about certain biases and try to help improve their behavior," says Ricciardi, who is co-editor of the 2014 book "Investor Behavior: The Psychology of Financial Planning and Investing."

And, don't forget to look in the mirror, he says. "Advisors tend to suffer from biases as well," he says. Learning to identify biases will help advisors and clients overcome them.

Clients often have positive or negative financial turning points that influence behavior later in life, Ricciardi says. "Clients can then develop money scripts, or money beliefs," he says. "If those experiences are negative and severe enough, clients can develop money disorders, like hoarding, for example."

**FP**

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Sean Allocca is an associate editor of *Financial Planning*. Follow him on Twitter @sjallocca.



## Too Much of a Good Thing

An abundance of software and practice tools has planners and firms overwhelmed. Here's what it means for the industry.

BY SULEMAN DIN

### AT WHAT POINT DOES AN ABUNDANCE BECOME too much?

Advisors now have a wide array of options for financial planning software, risk management and analytics platforms, asset allocation, rebalancing, digital marketing, CRM and cybersecurity tools – and it is leading to fatigue, technology executives acknowledge.

"It's almost too much choice," says John Connor, vice president, Schwab Advisor Services Technology Solutions. "RIAs are getting a lot of attention that they've never had before and advisors are in their offices saying, 'I don't know what to do, I need someone to help me with all these choices.' Ten years ago, we didn't have that. You'd be lucky to have two portfolio management systems."

Contemplating the surge in advisor technology growth, attendees at the recent T3 Enterprise conference debated sustainability of the niche. Many agree that proliferation in options is partly the result of client demands to deliver an experience comparable to Amazon, but also from increased investment into new providers and the ongoing breakaway advisor movement.

### 'FIRM FATIGUE'

Former SEC Commissioner Steven Wallman says there is "firm fatigue" among many advisors.

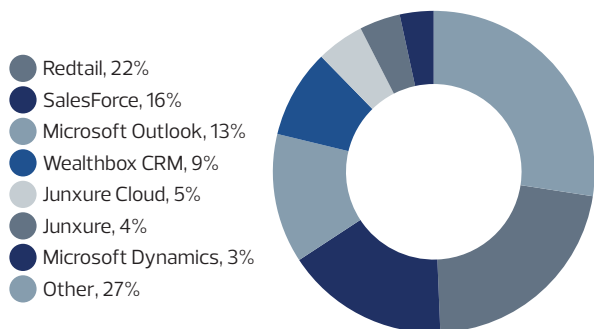
"Now everybody's got the next best solution," says Wallman, who is now CEO of FOLIOfn, a McLean, Virginia-based financial services firm that includes an institutional offering and an online brokerage.

"It's just too much. You end up either somebody picking for you, or you go back to less choice," Wallman says. "We're building out a service offering on our platform for two very large firms because they've given up. They don't want to pick and choose and they feel uncomfortable about making those choices."

MoneyGuidePro CEO Bob Curtis expects that consolidation will soon happen, as planning firms either limit choices

### The Application of Choice

RIAs' primary CRM software



Source: SourceMedia Research

available to their advisors or the market simply chooses winners in every category.

"There will be a movement toward reduction of choice," Curtis says. "Firms benefit from consistency, especially for proper compliance. I think firms will look realistically at what they can support within a firm, and some firms will go to one."

### THE RIGHT FUNCTIONS

Commonwealth Financial Network has adopted that strategy to supply technology to its independent advisors, says Darren Tedesco, the firm's managing principal for innovation and strategy.

"Through feedback, we make sure we have the functions being asked for," he says, acknowledging that the exception is financial planning tools, as Commonwealth supports six different options. "Advisors who choose Commonwealth are generally outsourcers and they trust our decisions and strategy. They don't want to build the next best mousetrap. They

want us to do that due diligence for them.”

### A SILVER LINING FOR RIAs

But the upside, adds Schwab's Connor, is



“There have been a lot of strategic investments in wealthtech and because of the DoL everyone is in the process of investing in new systems,” says Kendrick Wakeman, CEO of FinMason.

improved RIA practices.

“The crowd is always going to find greater innovation than [a core group of companies],” Connor says.

“So if we don't remain open to that from an integration perspective, innovation is never going to happen at the core. It's going to be critical if we want innovation in the RIA space,” he adds.

Stifled innovation is definitely the result of restricting technology choices, says Jeffrey Vivacqua, Cambridge Investment Research senior vice president of marketing.

“I wouldn't call it fatigue as much as being overwhelmed,” says Vivacqua, who notes Cambridge supports 10 different financial software choices for its advisors.

“But independent advisors are still glad they had those choices, instead of being pushed into a box,” he says.

Snappy Kraken CEO and co-founder Robert Sofia says that it is up to advisors to sift

**Stifled innovation is definitely the result of restricting technology choices, says Jeffrey Vivacqua, of Cambridge Investment Research.**

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through all the options available for their practice to find the ones that fit their business needs.

"Yes, there are so many options for CRMs, financial planning software, communications and marketing – it can be fatiguing but what's rewarding that's easy? If advisors think like entrepreneurs, they are going into their business to build something unique; that effort will pay off," Sofia says.

#### FIDUCIARY RULE EFFECT

Emphasis on improving the front-end experience and adapting to the demands of the Department of Labor fiduciary rule will continue to feed tech investment by wealth management firms, says Kendrick Wakeman, CEO of analytics firm FinMason.

"There will be consolidation, but not for a while," Wakeman says. "There's such an

open field for running right now. There have been a lot of strategic investments in wealth-tech and because of the DoL everyone is in the process of investing in new systems or upgrading old systems."

The debate over supply glosses over a critical point, says Lee Gordon, CEO of Mesirow Wealth Advisors. The best technology will always be in demand, he says, but advisors really are waiting for the industry at large to get better at working in concert.

"What advisors want to do, whether it's digital or analog, they want to be able to provide aggregation, performance reporting, all-in fees transparency, and deliver it 24/7," Gordon says.

"All the applications are there, but tying them together, making them an elegant, user-friendly experience for the client, that's the missing piece," he adds. **FP**

**"If advisors think like entrepreneurs, they are going into their business to build something unique; that effort will pay off," says Snappy Kraken CEO Robert Sofia.**

Suleman Din is technology editor of *Financial Planning*. Follow him on Twitter at @sulemandn.

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<sup>1</sup>Total client savings derived from annual average Monument Advisor contract size multiplied by MORNINGSTAR<sup>®</sup> average M&E of 1.35%, minus the \$240 flat-insurance fee of Monument Advisor, and then multiplied by the number of policies in force. Data spans May, 2005 through December, 2016.

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Variable annuities are long-term investments to help you meet retirement and other long-range goals. Withdrawals of tax-deferred accumulations are subject to ordinary income tax. Withdrawals made prior to age 59 1/2 may incur a 10% IRS tax penalty. Variable Annuities are issued by Jefferson National Life Insurance Company, (Dallas, TX), or Jefferson National Life Insurance Company of New York (New York, NY) and distributed by Jefferson National Securities Corporation, FINRA member. Policy series JNL-2300-1, JNL-2300-2, JNL-2300-3, JNL-2300-1-NY, JNL-2300-2-NY. All companies are members of Nationwide. JNL201710-A099

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## A Storm Is Brewing

There are drawbacks to a new law designed to help hurricane disaster victims access their retirement funds early without penalty.

BY ED SLOTT

### VICTIMS OF HURRICANES HARVEY, IRMA AND MARIA

— who may need to tap their retirement savings, including IRAs and company plans to rebuild after the storms — have received help from Congress. Whether it's best to accept it is more complicated than many advisors might think.

The new law eliminates the 10% early withdrawal penalty on distributions before age 59½ and lets savers spread any taxes on withdrawals over three years. It also lets them return the distributions back to their IRAs, 401(k)s and other plans within three years to get a refund of any tax they paid.

But while these provisions sound like a good deal — and may be for some — they are not a free lunch. Advisors should consider several risks in helping clients decide if retirement accounts are the best source of these needed funds.

### HOW HURRICANE VICTIMS CAN SAVE ON TAXES

The Disaster Tax Relief and Airport and Airway Extension Act of 2017 provides tax relief for “qualified hurricane distributions” to individuals who live within the disaster areas and experienced economic losses.

For people living in each of the following disaster areas, the distributions must have occurred on or after the following dates to qualify for the tax breaks:

- Hurricane Harvey: Aug. 23
- Hurricane Irma: Sept. 4
- Hurricane Maria: Sept. 16

In all cases, the distributions must be made before Jan. 1, 2019.

Here are the benefits:

Qualified distributions are not subject to the 10% penalty that otherwise would apply to funds taken from an IRA or other retirement plan before age 59½.

An individual can take up to \$100,000 as a qualified hurricane distribution. This limit applies to the amount taken from all plans combined. Married spouses can each take \$100,000, for \$200,000 total.

Employer plans are not required to impose 20% income



A new law allows victims of Hurricanes Harvey, Maria and Irma to withdraw funds from retirement savings plans without penalty.

tax withholding on distributions. While distributions are subject to income tax, the resulting income may be spread over three years to defer the tax due. Or an individual can elect to report the entire distribution in income in the year it occurs.

Individuals can return the qualified distributions back into their retirement accounts within three years, and receive a refund of any tax paid on the distributions. They get the refund by filing amended returns for the years in which the tax was paid.

These tax breaks together may provide individuals with valuable financial relief in a time of need, as illustrated in the following fictional situation.

### BEST-CASE SCENARIO

**Example:** George, age 49, lives in Houston where his home was destroyed by Hurricane Harvey. To get through the crisis, he withdraws \$60,000 from his IRA on Oct. 19, 2017. Fortunately, his finances recover, and he repays the \$60,000 back into his IRA before the three-year deadline of Oct. 19,

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2020. In fact, he makes the repayment just before the April 15, 2020, due date of his 2019 tax return. The benefits that George received include:

- No 10% early withdrawal penalty on the \$60,000 distribution.
- Reduced and deferred cash cost of income tax on the distribution. He paid tax on income of only \$20,000 each on his returns for 2017 and 2018, for only \$40,000 total. He owed no income tax on the distribution in 2019 because he returned the distribution to his IRA before his tax return for the year was due.
- Zero net income tax paid overall, after he obtained refunds of his tax payments for 2017 and 2018.

The result is that George effectively received a penalty-free and tax-free bridge loan of \$60,000 from his IRA to help him through his crisis.

#### **WHY YOU SHOULD BE CAUTIOUS**

George's result may seem great, but the benefit wasn't really tax-free and there was serious risk involved in his strategy.

First, even with the income deferral and final tax refund, he still had to pay tax on \$40,000 of income while in a cash crisis. He also lost the tax-deferred growth on the \$60,000 withdrawn from his IRA until he returned the funds, which could be a significant loss, too.

Moreover, if he hadn't been able to pay back the \$60,000 in three years, his IRA would have been permanently reduced by the unrepaid amount, with him paying a tax bill on the unrepaid amount that he'd never get back. Three years is a short time to repay a large amount in a disaster situation, so this was a risky gambit.

#### **LESS IDEAL SCENARIO**

Now consider a less ideal scenario.

**Example:** Harry, like George, takes \$60,000 from his IRA to pay for hurricane damage. But Harry's situation does not improve enough for him to return any of the \$60,000 to his IRA in three years. He must pay income tax on the full \$60,000. If he doesn't have the money to do so he might be

forced to withdraw more from his IRA and wind up paying tax on the money used to pay tax.

Moreover, his IRA is permanently reduced by \$60,000, costing him tax-favored investment returns on that amount for the rest of his life.

When advising clients, know these risks and consider IRA distributions only as a last choice option. It may be that in a dire situation, a client must take a distribution, but inform the client of the potential downsides before acting.

A safer strategy might be to seek a loan with a longer term from a conventional lender or through an emergency government-sponsored lending facility.

Then there is no need to raise cash to meet a current income tax bill, no loss of tax-deferred earnings and no risk of depleting retirement savings. Plus, there is much more time to repay the borrowed amount.

#### **MORE HELP FROM THE NEW LAW**

Another loan option is provided by the Disaster Tax Relief Act itself. The law increases the maximum that employees who live in hurricane disaster areas may borrow from their employer-sponsored qualified retirement plan accounts to \$100,000 from the former limit of \$50,000.

The law also eases the general rule that limits borrowing to one-half the value of an account so that they may borrow their full non-forfeitable balance.

The loans must be taken out after Sept. 29, 2017 and before Jan. 1, 2019. These loan provisions do not apply to IRAs, where loans are prohibited.

Borrowing is income tax free, so this option avoids owing current tax on a distribution and also provides more time to repay funds to the plan. Loans from a plan generally can be repaid over five years.

Also, employees who live in hurricane areas and already held outstanding plan loans prior to the disaster are eligible for a one-year postponement of repayments.

Another idea is to use a casualty loss deduction to offset the income tax cost of taking a distribution from an IRA or retire-

**When advising clients, consider IRA distributions only as a last choice option.**

ment plan to cover the cost of damage to property.

This is a logical concept, and the Disaster Tax Relief Act liberalizes casualty loss rules for hurricane victims, making larger deductions available to many. But be careful – there are traps in the rules for applying this deduction that can make it very risky.

The general rule is that a casualty loss deduction for personal-use property is permitted only to the extent that unreimbursed losses for the year exceed \$100 each, and their total exceeds 10% of adjusted gross income. The deduction can be claimed only on an itemized tax return.

deducted on non-itemized returns (although the per-loss deduction floor is increased to \$500 from \$100). These two changes can provide significantly larger deductions for many hurricane victims.

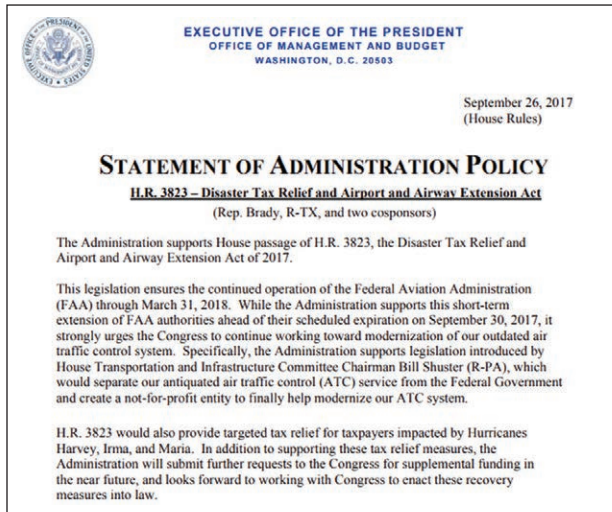
## TAX BREAKS FOR DONORS

The Disaster Relief Tax Act also gives a tax break to people who don't live in the path of the hurricanes, by giving them larger deductions for their charitable giving.

The new law suspends the normal deduction limits on contributions made to organizations helping storm victims. For instance, normally most people can deduct no more than 50% of their adjusted gross income for gifts to charity, and the limit may be only 30%, or 20% depending on the kind of property donated and the type of donee recipient.

These limits now do not apply to qualified donations from Aug. 23 to Dec. 31. Technical rules still do apply to different kinds of donations and gift recipients, so this is another issue to discuss with clients' CPAs. Tell clients that an approaching year-end deadline applies to get the larger deductions for

**Never assume that these tax relief provisions will help every client, as they all involve risks and potential traps.**



In addition, casualty losses suffered in a presidentially-declared disaster area can be deducted on the tax return filed for the year prior to that in which the loss occurred. This can provide two tax benefits: 1) faster monetary relief, as one can immediately file for a refund of tax paid for the prior year; and 2) possibly a larger deduction if, for instance, the individual was in a higher tax bracket or had less adjusted gross income in the prior year compared to the current year.

The new act further liberalizes the rules for hurricane victims by removing the adjusted gross income limit of 10% and allowing hurricane-caused losses to be

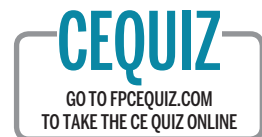
these gifts.

In times of unexpected hardship, advisors that know the tax relief provisions in the Disaster Tax Relief Act and give top-quality advice can earn a client's loyalty for many years to come.

But also remember that giving superficial advice can be toxic to the client relationship. Never assume that these tax relief provisions will help every client, as they all involve risks and potential traps.

Sweating the details on this issue is vital. Be sure to consider every client's holistic position in detail before writing a financial prescription.

FP



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## A Social Security Reality Check

Clients' SSA statements have invaluable information and are a great launch pad for discussing retirement planning.

BY PAUL NORR

**TO NUDGE CLIENTS INTO RETIREMENT PLANNING,** there's no better place to start than their Social Security statements. While it may be confusing at first glance, a statement is full of valuable information and provides a reality check on the benefits that clients anticipate receiving. Equally important, it gives you a launch pad for a broader discussion of retirement income planning.

While the Social Security Administration updates statements annually, your clients have good reason to be confused about whether they have their statement or how to get it. That's because the SSA has changed its distribution policies several times over the past few years.

The SSA started mailing annual statements to all future beneficiaries in 1999, but suspended those mailings in 2011 because of budgetary pressure. In May 2012, the mailings were restarted, but only for people over 60. Later that year, they were halted again.

Now, the statements are mailed out only to people 60 and older, provided they have not yet filed for benefits and have not established an online account.

Clients who aren't receiving paper statements or have lost them can access their latest one online after a brief registration process. Once they register with the SSA for online access, however, they will no longer receive mailed copies.

### GO TO THE BOTTOM LINE

Once a client has the statement, the two of you can go over the information it contains.

Page 2 offers the absolute bottom line for clients: estimates of their actual future benefits at different ages.

The first line, the full retirement age, is the linchpin number. This is the basic benefit, which kicks in at age 66 for the oldest baby boomers and will rise to 67 for the youngest. The next two numbers (age 70 and age 62) are calculated relative to the FRA base number. If your client is already 62 or older, the statement will list a "current age" estimate.

These values are only estimates, however. Here are three



important factors that can also have an impact on the level of clients' future benefits:

**1. Earnings after age 62:** If you have a 66-year-old client who is still working, her earnings after 62 are not included in these estimates. When she finally does apply for benefits, a recalculation is made accounting for all years of work.

**2. Cost-of-living adjustments:** The statement's estimates do not reflect future cost of living adjustments, which can significantly raise estimates. COLAs have averaged 1.7% over the last 10 years and 3.5% since 1975.

**3. Public-sector employment:** Clients who have worked for federal, state or local governments could be in for a shock. Their benefits could be reduced by hundreds of dollars a month for any public sector earnings for which they did not pay Social Security payroll tax.

The bottom of Page 2 outlines two regulations that affect these workers: the Windfall Elimination Provision and the Government Pension Offset. The WEP could reduce a monthly benefit by up to \$443. The GPO defines potential reductions to spousal benefits for a public sector worker.

Importantly, these potential reductions are not included

in the estimated benefits listed on Page 2. Advisers can provide critical assistance to clients by helping them understand and prepare for the potential effects of these features. .

Estimates of potential disability benefits, child benefits and survivor benefits are also listed on Page 2.

The statement does not, however, provide any information about possible spousal benefits, survivor benefits or divorced-spouse benefits. Estimates for these benefits are available only after an individual files for benefits and the SSA calculates the applicable amounts.

## **HISTORY IS CRITICAL**

You can also provide assistance to your client by taking a close look at two important inputs to those benefit estimates: total earnings and estimated future earnings.

The SSA calculates retirement ben-

efits based upon the highest 35 years of earnings for which a worker paid Social Security payroll taxes. Page 3 contains the exact yearly earnings in the SSA records that will go into one's estimated benefit. This list should include every working year in which your client paid payroll taxes.

If any yearly earnings are wrong or if years are missing, benefits could be miscalculated. Your clients should review these annual figures to see if they appear correct. If clients have documentation of meaningful mistakes, they should immediately notify the SSA, using instructions on Page 3.

Page 2 also lists the estimated future yearly earnings that the SSA uses for its calculations. The more years that your client has before retirement, the greater impact this number will have in the estimates. Clients who are more than five years away from filing should review this

number. Significant discrepancies could throw off estimates. The lower half of Page 2 provides more details on how benefits are calculated.

Finally, clients who grouse and complain that they'll never get their money back will be interested in the estimate on Page 3 of total taxes paid. This number shows how much money a worker actually put into the system. With some simple calculations, advisors should be able to demonstrate to most clients that lifetime benefit projections will handily exceed these contributions. That effort might ease their mind on this score.

The closer a client gets to filing for benefits, the more accurate the estimates become. Because of that, the statement is a great way to help clients annually course-correct their retirement income plan – with a clearer understanding of what those estimates really mean. **FP**

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Paul Norr is a CFP with Bucks County Financial Planning Group in Thousand Oaks, California. Follow him on Twitter at @paulnorr.

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# Investing in Marijuana

Here's what to tell clients certain that there's big money to be made by taking a chance on weed companies.

BY ALLAN BOOMER

**ABOUT A YEAR AGO, A CLIENT ASKED FOR MY** thoughts on investing in marijuana. I pride myself in being abreast of current events in finance, but this question caught me flat-footed. So I decided to educate myself.

First, I looked at publicly traded companies, and I was underwhelmed with what I found.

Most public companies that earn revenue from cannabis are micro-caps and penny stocks that trade over the counter. The small sizes of these companies make the investment feel speculative. And, as a practical matter, many advisor platforms don't allow penny-stock investing. Also, most of these companies are losing money. As a value investor, I find it hard to justify plowing investment dollars into companies that are bleeding money. What's more,

there aren't a lot of pure-play marijuana companies. Most of the companies I found had ancillary exposure to marijuana.

Despite these red flags, I made a very small investment at the client's request in a biotech company that was developing cannabinoid-based medicines. For almost a year, the investment lost money in the face of a smoking-hot equity market. It was time for some tax-loss harvesting.

## **SET FOR EXPLOSIVE GROWTH**

According to Arcview Market Research, the North American marijuana market recorded over \$6.7 billion in legal sales in 2016, after notching sales of more than \$5 billion the prior year. Separate analysis by Cowen estimates the market for legal marijuana will grow 20% to 30% a year to



\$50 billion by 2026.

Nevertheless, there are a number of distinct challenges to investing in legal marijuana companies. First, the federal government considers marijuana an illegal Schedule 1 drug alongside other substances with high potential for abuse like heroin, LSD and ecstasy. Although 29 states and Washington, D.C., have passed legalization measures, this federal restriction creates several issues.

For example, the product cannot be transported across state lines. In addition, the banking and insurance industries have shunned the marijuana market. In 2016, only 301 of the nation's 12,000 banks and credit unions worked with cannabis companies, according to Arcview. It is estimated that 70% of weed-based businesses do not have bank accounts.

Additionally, insurance companies do not insure the marijuana plant itself, which caused huge losses for some weedpreneurs impacted by the California wildfires.

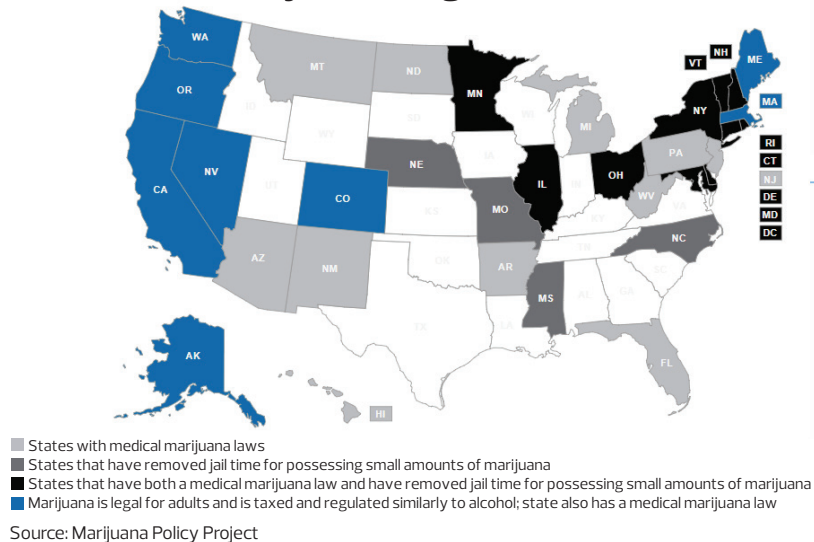
And then there are taxes. IRS rule 280E prohibits companies that profit from Schedule 1 drugs from writing off operating expenses. That means a marijuana dispensary is effectively taxed on sales, because it cannot claim expenses like rent and wages.

This proves to be a big disadvantage when compared with every other business. The marginal tax rate for cannabis companies can be as high as 70%, as opposed to 30% for other types of businesses, according to Arcview.

### SHOULD YOU INVEST?

The current public equity market for marijuana is hit or miss. Perhaps the best opportunities in marijuana stocks will come from outside the U.S. Canada is taking steps to legalize recreational use nationwide by July 2018, which could be a game changer.

## States Where Marijuana Is Legal in Some Form



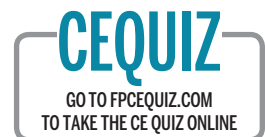
This fall, Constellation Brands, the owner of Corona Beer, bought a 9.9% stake in Canopy Growth, a Canadian medical marijuana company. Perhaps other major beverage, tobacco and agricultural companies will jump in.

With private companies, investors must apply the same process they would in evaluating any VC deal. You must look at the experience of the team. Jacob Bell, co-founder of Patient Relief of Ohio and an early marijuana investor in California, says, "This is an industry that is run by former illegal drug dealers and users, so you have to be very careful."

Additionally, you want to understand the licensure process for a state, and the legal status of the business you are evaluating. This is a highly regulated industry, and compliance is key.

Last, you want to understand the unique value proposition of the company. "Marijuana users are developing very sophisticated palettes," says Rob Kurz, a client of mine who is part of a group that is pursuing cultivation and processing licenses in California. "They are beginning to acquire a taste for high-quality products and specific strains that they enjoy." In other words, weed is becoming the new wine.

**Yes, the legal marijuana market is flying high, but pot companies face steep taxes, banking restrictions and other difficulties.**



Allan Boomer is managing partner and chief investment officer at Momentum Advisors. Follow him on Twitter at @BoomBoom4Real.

# PORTFOLIO

ALSO IN PORTFOLIO: P. 65: Trimming Longevity Risks | P. 67: Ways to Create Tax Alpha

## Fear of Falling

You know how much clients hate it when markets suffer a steep decline. Here are key facts to help them cope when asset classes are underwater.

BY CRAIG L. ISRAELSEN

**CLIENTS – AND EVEN SOME ADVISORS – OVERREACT** to market losses, even though they occur far less frequently than gains.

Are they on to something? Consider the longtime performance of the S&P 500. This index has produced a positive annual return about 75% of the time since 1926. Even after accounting for inflation, it has had positive annual real returns roughly 70% of the time.

Think of it this way: An extraordinary batting average in baseball is .400, but in playing the stock market game, investors have had a batting average of .700 over the last nine decades.

### SEVEN CORE ASSET CLASSES

But look past the S&P 500. How often do other asset classes have negative returns? And, once a loss occurs, how long does it take for an asset class to recover? These are two questions worth a close examination.

To explore, we'll focus on seven core asset classes that are often used in investment portfolios. Each of these asset classes has a performance history going back to 1970: large-cap U.S. stocks, small-cap U.S. stocks, non-U.S. stocks, real estate, commodities, U.S. bonds and cash.

To measure the performance of these classes, large-cap stocks will be represented by the S&P 500, small-cap stocks by the Russell 2000, non-U.S. stocks by the MSCI EAFE index, real estate by the Dow Jones U.S. Select REIT index, commodities by the S&P Goldman Sachs Commodity index, bonds by the Barclays U.S. Aggregate Bond index and cash by the 90-day Treasury bill. We will also examine the behavior of a portfolio composed of all seven indexes in equal allocations of 14.29% (with annual rebalancing).

As shown in the chart "Summary of Asset Classes," real estate has been the top performer overall in the 47-year period from 1970 to 2016, generating an average annualized nominal return of 11.94% (7.6% after adjusting for inflation).

### Summary of Asset Classes

Real estate has generated the highest average annualized nominal return among seven asset classes.

47-Year Period From 1970 to 2016	47-Year Annualized Nominal Return (%)	47-Year Standard Deviation of Annual Returns	47-Year Annualized Real Return (%)	Percentage of Years With a Positive Nominal Return	Percentage of Years With a Positive Inflation-Adjusted Real Return	Most Recent Negative Nominal Calendar Year
Real Estate	11.94	18.76	7.6	83	77	2008
U.S. Small-Cap Stocks	11.02	21.58	6.72	70	68	2015
U.S. Large-Cap Stocks	10.31	17.12	6.03	81	72	2008
International Stocks	8.62	21.82	4.41	70	64	2015
Commodities	7.01	25.21	2.87	70	64	2015
Bonds	7.62	6.56	3.45	94	72	2013
Cash	4.95	3.53	0.88	100	60	N/A
7-Asset Portfolio	9.82	10.16	5.56	87	74	2015

Source: Steele Mutual Fund Expert, calculations by author

Moreover, it has achieved positive calendar-year returns 83% of the time. After accounting for inflation, real estate has produced positive real returns in 77% of the years.

Real estate has produced a negative nominal return just 17% of the time since 1970. That is an outstanding success ratio. The last negative calendar year for real estate was 2008, at the height of the financial crisis.

Small-cap U.S. stocks have been the second-best performer, with a 47-year annualized nominal return of 11.02%, 6.72% after inflation. This asset class has had a positive calendar-year return 70% of the time over the past 47 years, and 68% of the time after accounting for inflation.

Large-cap U.S. stock had a 47-year annualized return of 10.31% and real return of 6.03%. The S&P 500 had positive nominal returns 81% of the time and positive real returns 72% of the time. The last negative year for the index was also in 2008.

It's worth noting that cash shows positive nominal returns for all 47 years, but, after accounting for inflation, it had a positive real return only 60% of the time – the lowest percentage among all seven asset classes.

A portfolio with equal allocations of all

seven asset classes has performed admirably over the past 47 years, producing an average annualized nominal return of 9.82%, with a standard deviation of 10.16%. The standard deviation for the multiasset portfolio has been dramatically lower than that for any of the so-called performance engines (real estate, U.S. small-cap stocks, U.S. large-cap stocks, international stocks and commodities). Additionally, the seven-asset portfolio had a positive nominal return 87% of the time, and a positive real return 74% of the time.

#### ENDURING THE RECOVERY PERIOD

Over the past 47 years, each core asset class has produced a positive return at least 70% of the time before inflation, and at least 60% of the time after inflation. But, despite having very good batting averages, these asset classes do, of course, experience negative returns, which translate into temporary portfolio losses. Over time, these core asset classes have always recovered.

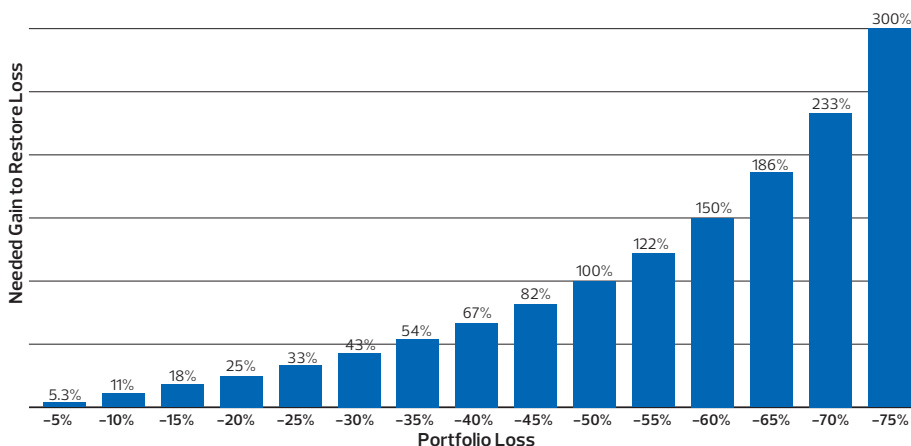
The question is: Do advisors and their clients have the persistence to endure the recovery period?

Clearly, it is a challenge. Portfolio losses don't play fair, because it takes a proportion-

**If a portfolio is effectively diversified, the odds of a substantial loss are relatively low. If one occurs, however, the solution is to have a steady hand.**

## The Math of Loss and Recovery

The bigger the portfolio loss, the bigger the gain needed to recover.



Source: Author's calculations

ally bigger gain to break even from a loss. Thus, even though all the key asset classes have positive nominal and real returns most of the time, the losses that they do experience can be disproportionately painful.

This situation is shown in "The Math of Loss and Recovery." As the portfolio decline increases, the needed gain to restore the loss also increases. For example, a portfolio loss of 35% requires a 53.8% cumulative gain to restore the portfolio to its value prior to the loss.

A loss of 50% requires a 100% gain to break even. A 75% loss requires a 300% gain to recover the lost account value. The primary goal of a diversified investment portfolio should be to provide a reasonable rate of return while minimizing the frequency and magnitude of losses.

## HAVING A STEADY HAND

The S&P 500 lost 37% in 2008, but a diversified seven-asset portfolio fared better, with a loss of only 27.6%. As the chart shows, a loss of 40% requires a 67% gain to break even, while a loss of 25% requires a gain of only 33% to fully recover.

It's important that advisors have a steady hand during periods of losses. The reality is that losses occur, but so does recovery. What's needed most when markets are in a down period is patience and perspective from both advisors and clients.

This is shown in the table "Downturns and Recoveries," which focuses on large-cap stocks and a seven-asset portfolio. Over the past 37 years, using monthly performance data from 1980 through 2016, there is a 15% chance that U.S. large-cap stocks will lose up to 5% in a 12-month period. There is an 11% chance of a loss of up to 10%, a 6% chance of a loss of up to 15% and a 5% chance of a loss

## Downturns and Recoveries

In a majority of cases, investors have recovered market losses within 36 months.

Loss	Needed Cumulative Gain to Break Even	S&P 500	Diversified Portfolio (Equal Mix of 7 Asset Classes)
<b>Historical Frequency of Various Losses Over Rolling 12-Month Periods*</b>			
-5%	5.3%	15%	6%
-10%	11.1%	11%	3%
-15%	17.6%	6%	3%
-20%	25%	5%	2%
<b>Historical Frequency of Producing Needed Cumulative Gain to Restore Various Losses Within 36 months*</b>			
-5%	5.3%	83.4%	87.5%
-10%	11.1%	80.4%	83.6%
-15%	17.6%	77.8%	80.9%
-20%	25%	75.6%	67.7%

\* Probabilities of recovery calculated using historical rolling 36-month cumulative returns from 1980 to 2016. Source: Steele Mutual Fund Expert, calculations by author

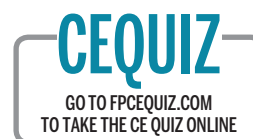
of up to 20% within a 12-month period.

Next, let's look at how often the amount lost has been recovered within 36 months, also going back to 1980. After experiencing a loss of 5%, the S&P 500 has 83.4% of the time generated the needed cumulative recovery return of 5.3% within a 36-month period.

From a loss of 10%, the needed return is 11.1%, which the S&P 500 has managed 80.4% of the time. A 15% loss requires a 17.6% cumulative gain for recovery, which the S&P 500 has accomplished 77.8% of the time. Finally, a loss of 20% requires a 25% cumulative gain to break even, and the S&P 500 has generated this needed return 75.6% of the time.

There is only a 3% chance that a well-diversified portfolio will experience a 15% loss during a 12-month period. The good news is that, based on historical data, there is an 80.9% chance this diversified portfolio will fully recover within 36 months.

In light of this history, advisors can help clients get through tough market times by explaining that when it comes to losses, they are typically not long-lasting if investors don't abandon a diversified portfolio. **FP**



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## Trimming Longevity Risks

An annuity-laddering strategy can deliver good returns while addressing clients' fears, if executed properly.

BY DONALD JAY KORN

**AS LIFE EXPECTANCIES STRETCH, CLIENTS MAY** worry that they will outlast their savings. An annuity-laddering strategy could help provide lifelong cash flow, thus trimming this longevity risk and easing clients' concerns.

Holding annuities can help clients achieve "peace of mind," says David Buckwald, senior partner and co-founder of Atlas Advisory Group, a financial planning firm in Cranford, New Jersey – even when considering the peril posed by a possible bear market near the start of retirement.

These potential pros do come with some cons. Annuities can be illiquid and relatively expensive. Today's yields are modest, as is the case with many vehicles now. Moreover, the products used to construct a ladder range from straightforward immediate annuities (also known as income or payout annuities) to complex arrangements that require extensive advisor research and detailed explanation to clients.

### INCOME AND SAFETY

Annuity ladders can come in various shapes and uses.

"For income ladders, clients can ladder the annuity purchase date or the income start date ... or both," says Stan Haithcock, an independent annuity agent in Ponte Vedra Beach, Florida, who promotes himself as Stan the Annuity Man. "For principal protection, I ladder contractual guarantees."

His current principal protection ladder includes multiyear-guaranteed annuities with three-, four- and five-year guarantees. The guarantees here are promises from the insurers, so clients are relying on the continued financial strength of those companies.

"Rates depend on the state of residence and the rating of the carrier," Haithcock says. "The three-year is the shortest duration MYGA I'm willing to buy, and the five-year is the longest I am allowing my clients to lock in. For three-year paper, the rate is

around 2%, four-year paper pays 2.2% to 2.4% and the rates for five-year paper are 2.65% to 3.1%."

The MYGAs Haithcock mentions promise the stated yield for the stated time period. Penalties may apply for withdrawals before the expiration of the guarantee. When the guarantee expires, a MYGA can be renewed or moved to another issuer, with a more appealing rate.

MYGAs are similar to bank CDs, except that income tax can be deferred until money is withdrawn. (Withdrawals before age 59½ may trigger a 10% penalty in addition to ordinary income tax.) Advisors who compare MYGAs to CDs may need to ensure clients understand that annuities don't have the same federal guarantees many bank accounts enjoy.

### MIX AND MATCH

Different types of products can occupy different rungs on annuity ladders.

"I use annuity ladders to create a guaranteed income stream starting at some point in the future, usually 10 years from the purchase," says John Scheil, CEO and owner of Cardinal Retirement Planning in Cary, North Carolina. "The annuities cover the lifetime of either one individual or the

### Sales Trends

Some of the annuity types that may be used in ladders.

Total Sales (\$ billions)				
	2016	2015	2014	2013
Variable Annuities	104.7	133	140.1	145.4
Fixed-Rate Deferred Annuities	38.7	30.9	30.8	29.3
Fixed Indexed Annuities	60.9	54.5	48.2	39.3
Single-Premium Immediate Annuities	9.2	9.1	9.7	8.3
Deferred-Income Annuities	2.8	2.7	2.7	2.2
Qualified Longevity Annuity Contracts	0.3	0.3	N/A	N/A

Source: LIMRA

individual and spouse. I show them the monthly income floor that is guaranteed by the insurance company to be paid for the rest of their life or lives.”

For these rungs on the ladder, Scheil uses deferred fixed-indexed annuities with a guaranteed lifetime withdrawal benefit. FIAs also are CD cousins, with returns not fixed but pegged to one or more market indexes. FIA returns typically are limited on the downside by insurer guarantees, and capped on the upside.

Previously, Schiel's ladders also used fixed-period annuities that paid the income amount immediately, for 10 years. “With interest rates so low,” says Scheil, “these fixed-period annuities are hardly worth buying. In many cases, I have replaced the second annuity with a managed account invested in a five-year bond ladder of ETFs. Here, the client withdraws monthly income from principal and interest for the first 10 years.”

Haithcock also has a “mixed fixed” ladder, which is a combination of MYGAs and FIAs. “I use FIAs with no attached riders,” he says. “FIAs historically have provided an enhanced CD return.”

His mixed fixed ladder combines three- and five-year MYGAs with six- and seven-year FIAs. For FIAs, the years on the ladder represent the surrender charge period. The key to the mixed fixed ladder, Haithcock asserts, is that there are no annual fees, because no riders are attached.

For income-oriented ladders, Haithcock uses single-premium immediate annuities, deferred-income annuities and qualified longevity annuity contracts. With SPIAs, cash flow commences with the upfront investment. DIAs delay the cash flow, in order to boost the yield. Finally, QLACs are a form of DIA, for use in IRAs, that typically start late in life and reduce required distributions.

## PROCEED WITH CAUTION

Annuity ladders may have a place in some clients' portfolios, but there is some advisor concern about the product. The idea of lad-

dering annuities inspires discouraging words from some industry experts.

“We have discussed laddering annuities, but we have not yet implemented this approach for any clients,” says Tom Orecchio, a principal and wealth manager at Modera Wealth Management in Westwood, New Jersey.

“Conceptually, we think the strategy has merit, but we do have concerns,” he adds.

## OVERCOMING RELUCTANCE

The greatest concern, according to Orecchio, is the lack of access to principal. “Although we understand that an annuities ladder can be similar to an indexed pension, once clients see an account balance, it is difficult for them to overcome their reluctance to give up access to that principal. With most pensions, people never had access to the principal to begin with.”

Another worry is regarding the loss of principal or lifetime income in the event of a premature death.

“There are ways to overcome this drawback, such as using a joint and survivor payout, but this is another hurdle for investors,” Orecchio says. “Some annuities now offer riders to address this issue, but such riders can be expensive.”

Such objections are common to annuities, but what about the idea that lifelong annuity payments can modify longevity risk? “Fortunately,” says Orecchio, “for most of my clients, longevity risk and running out of money is not a primary issue.”

Buckwald, of Atlas Advisory Group, also is not currently using annuity ladders, although he has put clients into them in past years.

“We're going to a bucket strategy instead,” he says, “with money feeding from long-term to immediate-term to short-term buckets. Annuities can fit into this method. Research shows that people who have traditional pensions tend to live longer and live happier in retirement, with less stress. Fewer people have pensions these days, but annuities can provide that kind of cash flow when they make up a portion of a client's portfolio.” **FP**

**The key to the 'mixed fixed' ladder is that there are no annual fees, because no riders are attached, says Stan Haithcock, an independent annuity agent.**

**CEQUIZ**

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## 8 Ways to Create Tax Alpha

Here are some traditional and under-the-radar ways to help clients earn more after taxes.

BY ALLAN S. ROTH

**IF THERE'S ONE THING EVERY CLIENT WANTS TO DO,** it's to make more money after taxes. Advisors can add value for clients when it comes to optimizing their tax tactics.

Here are eight strategies for generating tax alpha for your clients, from conventional practices to more-unusual off-label product moves. Tax law is complicated, and these strategies can be as well, but making the effort can help advisors differentiate their practices.

### TRADITIONAL TAX ALPHA

**1. Product selection:** With stocks repeatedly setting records this year, active mutual funds are passing through gains to clients. The average turnover of active equity mutual funds is 63%, according to Morningstar Direct. This creates both short- and long-term taxable gains, and also results in lower returns even before taking into account these taxable consequences.

Even formerly hot active mutual funds can get into a death spiral, creating a tax trap. For example, the Columbia Acorn Z (ACTWX) lost 0.44% in 2015, but passed on a \$7.14-per-share capital gain when the fund had to sell stock to honor redemptions as investors fled.

Broad stock index funds of the mutual fund or ETF variety have little to no turnover, and leave you and your client in better control of when to recognize gains.

**2. Asset location:** Risk is determined by asset allocation and product selection. Once this is done, choosing the right tax wrapper is crucial.

Some assets are best located in taxable accounts and others in traditional tax-deferred accounts. In general, tax-efficient vehicles with high growth potential, such as stock index funds, belong in the taxable accounts. That's because the dividends are taxed at lower rates and the client is in control of when the gain is recognized.

Owning stocks in a traditional IRA or 401(k) account eventually turns what would have been a tax preference item into ordinary income, thus typically resulting in a



BLOOMBERG NEWS

higher tax rate.

Tax-free Roth accounts are a third tax wrapper. REITs or REIT index funds are perfect for this tax wrapper, because the dividends are taxed at higher rates and REITs also offer the opportunity for growth.

**3. Tax diversification:** I'm often asked which accounts I prefer — taxable, tax-deferred or tax-free wrappers. My answer is all three. None of us know what our tax rate will be in retirement, or what changes in tax law might occur.

Thus, using all three is a form of political diversification. If, for example, marginal tax rates increase, then the Roth would look attractive. If we move to a consumption tax like the Fair Tax Act, the client pays taxes on the money when she contributes and again when she spends the money.

**4. Tax-loss harvesting:** I tell clients who are fretting about portfolio losses, "I'm sorry for your loss, but make the most of it."

While typically only a \$3,000 loss per year can be recognized, an unlimited amount can be carried forward and used to offset future gains. Be sure to avoid buying back the same security within 30 days (wash rules). This can be done

without exiting stocks for a month by buying a similar fund.

**5. Withdrawal strategies:** Generally, clients should spend taxable assets first, tax-deferred assets second and Roth assets last.

However, clients often have an opportunity to pay taxes sooner at a lower marginal rate. If, for example, a client retires before age 70 but elects to delay Social Security until age 70, the client's income may be very low, leading to a lower marginal tax rate.

This creates an opportunity to take funds out of the traditional IRA/401(k) wrapper sooner, with a lower tax rate, rather than later, when the client is taking Social Security and must take the RMD, leading to a higher tax rate.

Two ways of taking money out are making a simple withdrawal into a taxable

For example, if they convert three IRAs and one is in a REIT index fund that loses 37% of its value (as it did in 2008), recharacterizing essentially makes the government buy back its share at the original price.

Many states also have a pension exemption so some of the conversions can be free of state income taxes.

**7. Using HSAs to get both a deduction and tax-free growth:** If your client has a high-deductible health plan that qualifies for an HSA, they get a tax deduction in the year they contribute. They get the same benefit as a traditional IRA. But rather than reimburse themselves for out-of-pocket health care expenses, clients can pay with taxable dollars and keep a tab on expenditures.

This means they can reimburse themselves at any time, even decades later. They can also use these funds to pay Medicare premiums and long-term care premiums and expenses.

**8. Use muni bond funds to get tax losses without economic losses:** Interest rates have declined and muni-bond coupon payments are higher than the SEC yield.

The SEC yield represents the fund's true income and carves out any return of capital that is included in the distribution yield.

Vanguard Long-Term Tax-Exempt Admiral (VWLUX) has an SEC yield of 2.37% as of Oct. 26. Though this is the true income, the total distribution yield is 3.49%, meaning roughly 1.12 percentage points is return of principal from an economic perspective.

If this continued for a year, an estimated loss of the net asset value of 1.12 percentage points could occur. You can then have your client recognize this loss, even though they actually received the 1.12 percentage points via a tax-free coupon payment.

If these strategies are implemented correctly, clients will make more money after taxes, often while actually lowering risk. **FP**

**I tell clients who are fretting about portfolio losses, "I'm sorry for your loss, but make the most of it."**

## Choosing the Right Tax Wrapper Is Crucial

Taxable Accounts	Tax-Deferred Accounts
Broad stock index funds	Taxable bonds
Low-turnover stock funds	REITs
Tax-managed funds	CDs
Individual stocks	High-turnover stock funds
	Fun gambling stock accounts

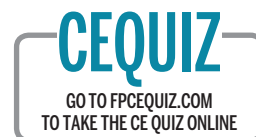
account and converting some to a Roth.

### OFF-LABEL TAX-STRATEGIES

**6. Multiple Roth conversions with a put to recharacterize:** One way to get more money into the Roth tax wrapper is to convert traditional tax-deferred money to Roths. Every year, I do several Roth conversions and put each one in a separate asset class.

If I do the conversions in early January, I have over 22 months during which I can undo the conversion, in what's called a recharacterization. I explain to clients that a traditional IRA/401(k) is really jointly owned by themselves and the federal and state governments. If the client is in the 30% marginal tax bracket, they own 70%, and a conversion is buying out the government's share.

**Allan S. Roth**, a *Financial Planning* contributing writer, is founder of the planning firm Wealth Logic in Colorado Springs, Colorado. He also writes for *The Wall Street Journal* and *AARP the Magazine* and has taught investing at three universities. Follow him on Twitter at @Dull\_Investing.





# CE QUIZ

## DECEMBER 2017

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### FROM: FEAR OF FALLING

1. Based on an analysis tracking performance from 1980 to 2016, what is the chance an equal-allocation portfolio composed of large-cap U.S. stocks, small-cap U.S. stocks, non-U.S. stocks, real estate, commodities, U.S. bonds and cash will experience a 15% loss over a 12-month period?

1. 8%
2. 10%
3. 3%
4. 7%

2. If such a loss occurs, what is the chance this portfolio will fully recover the losses within 36 months, based on analysis of historical data?

1. 80.9%
2. 75.2%
3. 92.5%
4. 68.8%

### FROM: THE FALLACY OF 401(k) LOANS (Online only)

3. Which Internal Revenue Code did Congress create to allow employees to take loans directly against their 401(k)s?

1. IRC Section 72(p)(1)
2. IRC Section 72(p)(2)
3. IRC Section 72(p)(2)(B)
4. IRC Section 72(t)

4. When taking a loan against a 401(k) plan, how long would the client have to pay it back in a timely manner, per the Internal Revenue Code?

1. Three years
2. Seven years
3. Five years
4. Two years

### FROM: A STORM IS BREWING

5. To qualify for a tax break from Hurricane Harvey, Irma or Maria relief distributions, all such distributions must be made before what date?

1. Jan. 1, 2018
2. Jan. 1, 2019

3. March 15, 2018

4. March 1, 2019

6. What is the most an individual can take as a qualified hurricane distribution?

1. \$200,000
2. \$100,000
3. \$50,000
4. \$150,000

### FROM: A SOCIAL SECURITY REALITY CHECK

7. The Social Security Administration has suspended mailings of annual statements to all workers except those what age or older (as long as they have not filed for benefits and do not have an online SSA account)?

1. 65
2. 58
3. 70
4. 60

8. By up to how much can monthly Social Security benefits be reduced for public sector earnings under the Windfall Elimination Provision?

1. \$250
2. \$523
3. \$443
4. \$373

### FROM: INVESTING IN MARIJUANA

9. How high can the marginal tax rate for cannabis companies be, according to Arcview Market Research?

1. 65%
2. 70%
3. 80%
4. 55%

### FROM: 8 WAYS TO CREATE TAX ALPHA

10. Which of these would best be held in a taxable account?

1. REITs
2. CDs
3. High-turnover stock funds
4. Broad stock index funds

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# SELFIE

## Revolutionizing a Practice

When disaster struck, this tool helped Titus Wealth Management find clients in minutes.

BY ERIC M. AANES



**IT WAS STILL DARK OUTSIDE WHEN, ON A RECENT** October morning, I suddenly woke to the smell of smoke. In my half-asleep daze, I thought for a second that I was back on a campsite. Had I forgotten to fully extinguish my fire?

Then my heart dropped.

I was at home in Kentfield, California, safely in bed. What I smelled were the effects of wildfires that were more than 30 miles away.

At that moment, I quickly realized my clients, friends and colleagues were at risk and would surely be impacted in some way.

### REACHING OUT

It was hard for me to fall back asleep that morning, and after tossing and turning, I decided to head into work early. When I arrived, I found my team ready to respond to the crisis. I asked them to quickly examine their client rosters to identify who might be most at risk.

Thanks to the Redtail CRM software we use, I had my answer in less than 15 minutes.

We used the program to search for clients in ZIP codes affected by the wildfires, and within the hour, we reached all 47 of those clients. Some were panicked. Some remained calm. All were grateful we had called.

### REASSURE

In that moment, we wanted to accomplish two things. First, we needed to make sure every client was safe. Second, we wanted to reassure them that their financial and trust documents were secure in our electronic files.

Clients, who need to move quickly to protect their family

and most prized possessions, shouldn't have to worry about digging out old tax returns or estate plans. That's one way good software comes in handy. Redtail provided a comprehensive overview of the documents we were storing.

It was an incredible testament to how certain tech tools can revolutionize a practice.

That morning, we were relieved to discover that most of our clients had already evacuated. One client, however, didn't have anywhere to go as the fire was closing in. Her advisor had an extra room available and, without hesitation, invited her to stay.

Thankfully, all of our clients displaced by the fires are back in their homes. Only one family experienced a total loss, on a second home in Napa.

### RECOVERY PHASE

Now, as we enter the recovery phase, we are relying on technology to guide our follow-up efforts. We are using software to keep track of client updates and track those who may need our assistance in managing post-disaster money management tasks.

As the fires raged on, it was a scary situation for everyone in the community. There was no way to tell how many people would be impacted and to what extent.

Our job as advisors is to support our clients and be their partner through life's big events. Helping them through the devastation of the wildfire was no different.

The fact that we were able to check in with all of our local clients within two hours was tremendous. We wouldn't have been able to do it without the power of technology and a supportive team.

**FP**

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Eric M. Aanes is president of Titus Wealth Management, an RIA in Larkspur, California. Follow him on Twitter at @EricAanes.

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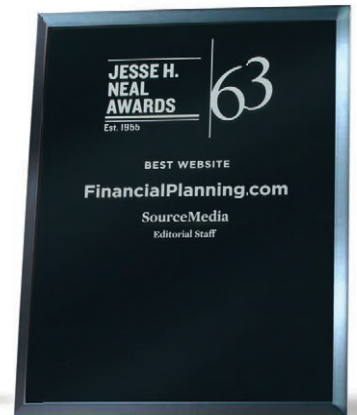
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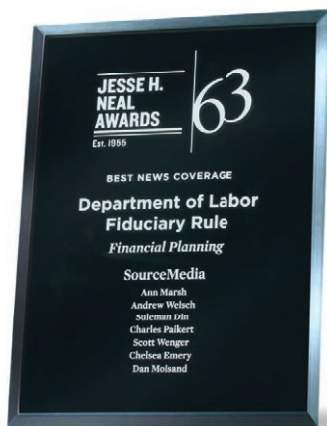
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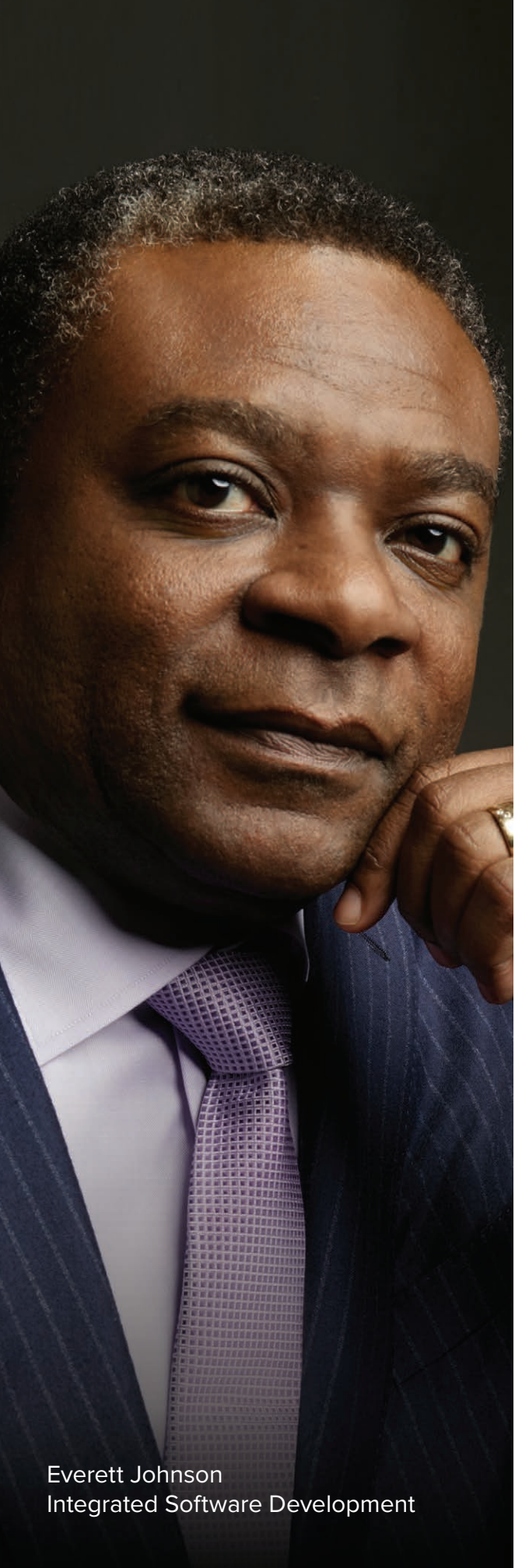
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