Active Decisions

There were two stories this past week about Fidelity Investments that seem to be very much related and could signal how things may play out in the asset management industry going forward.

The first was about a price war among the discount brokerages. Here are the details courtesy of ThinkAdvisor:

A price war has erupted among discount brokers, joining a war already underway among index mutual funds and ETFs. Less than a month after Schwab cut commissions $2 to $6.95 a trade, Fidelity Investments announced a $3 drop to $4.95 per trade early Tuesday and within hours Schwab matched it.

Fidelity and Schwab also lowered options prices from 75 cents to 65 cents per contract. In addition, Fidelity reduced its margin rate on balances of $500,000 or more to 4%.

Schwab had cut mutual fund and ETF fees in early February, along with trading commissions, reducing expenses to 0.03% for its S&P index Fund, to 0.06% for its Small-cap Index fund and to 0.04% for its Aggregate Bond Index Fund – all below costs for equivalent funds from Fidelity and Vanguard, which, except for the Fidelity 500 index Fund were in double digits.

Just the day before this one hit, there was another story from Bloomberg on some personnel changes at Fidelity as well:

Fidelity Investments is offering buyouts to 3,000 veteran employees to reduce costs and open opportunities for newer staff, according to a person with knowledge of the matter.

Employees who are 55-years old by June 30 and have worked 10 years at the company will be eligible for the offer, said the person, who asked not to be named because the information is private. The packages will include extended health-care coverage and at least six months of salary. The proposal covers about 6.7 percent of the firm's 45,000 employees.

Costs cuts had to turn into job cuts at some point within many fund firms who have been getting away with charging very high fees for many decades now. With low fee shops like Vanguard and iShares dominating the fund world these past few years, this was bound to happen. My guess is the years ahead will see more of these cuts along with consolidation in the fund industry through mergers and acquisitions. The relentless bull market has masked a lot of issues within these companies as rising assets have made up for fund outflows for many actively-focused fund firms. That won't last forever.

Active management still holds the majority of the assets worldwide but the move into low-cost ETFs and mutual funds is a secular shift that's likely not slowing down anytime soon. So the active

management industry is going to have to adapt, as are many of the employees who work on this side of the fund world.

I've always thought the active versus passive debate that occurs mostly among people who work in the investment industry isn't very helpful. As Rick Ferri once said, "Investment return is purely a function of total risk exposure minus cost. All else is smart marketing."

Investing will always be about making active decisions, but not the kind the fund industry would have you believe. There are a number of ways in which financial professionals can earn their keep by actively managing client assets. It's just that most investment professionals spend their time and energy focusing on the wrong active decisions. Investment advisors can have a much greater impact by:

- Actively defining a client's true goals and objectives.
- Actively setting investment policies and guidelines.
- Actively getting to know their clients' risk profile, time horizons, fears, and desires.
- Actively making asset allocation decisions.
- Actively reviewing and controlling for fees.
- Actively managing tax efficiency.
- Actively educating and communicating with clients.
- Actively making their client's lives easier.
- Actively designing a strategic portfolio to help people achieve their goals.
- Actively managing client behavior and emotions.
- Actively providing advice on savings, retirement withdrawal strategies, and estate planning.

Fees will continue to fall and the cost to put together a portfolio is on the way to becoming a rounding error. But instant access to market prices, the ability to trade on your smartphone and lower trading costs make it harder for investors to behave. Barriers to change have never been lower. You can easily give back any cost savings from lower fund fees and trading expenses with one poor decision.

So behavior will exert the biggest costs on investors and their portfolios, regardless of what they're paying for a fund or trade.

Actively managing client behavior is something the majority of fund firms don't spend enough time on. So much focus is on security selection, marketing and gathering assets that it's almost as if the end users of their products don't matter. Those firms who are able to pay more attention to their clients and help them make better, more informed decisions can separate themselves from the pack.

Active management is not dead by any stretch of the imagination but many in the active management game may have to change the things they actively manage to stay relevant in the

new world of lower fees.

Source:
Fidelity Said to Offer Buyouts to 3,000 Veteran Employees (Bloomberg)
Fidelity Cuts Trading Prices, and Schwab Follows (ThinkAdvisor)

Further Reading:
Great to See You Active Management - Are You Still Alive?