BILL CRAGER / JAY HUMMEL

FOREWORD BY JEAN CHATZKY
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The ESSENTIAL ADVISOR

Building Value in the Investor-Advisor Relationship

WILEY

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To our families, colleagues, clients, and friends who make us better every day

Foreword

On January 6, 2016, the day Bill Crager and Jay Hummel asked me to write the foreword for this book, the Dow marked its worst four-day start to a year on record. Crude oil sank to a seven-year low. And that was just the bumpy beginning of a tumultuous month—a month marked by headlines with words like: *Plunge. Bear. Wild.* Even *Ouch* (kudos, CNN.com). It was a month when I found myself on the air repeating the same mantra over and over: *I know it's hard, but try to be calm. As long as you're in it for the long term, do your best to stick to your plan.*

Still, you couldn't blame even seasoned investors for their frazzled nerves. The stakes Americans have in securing their own comfortable financial futures have never been higher. We are responsible for our own finances to a degree that earlier generations never imagined. The pensions that were there for our grandparents (and a few of our parents) are largely gone, replaced by 401(k)s and other defined contribution accounts that we have to fund and manage ourselves. Employer-sponsored health care is fading quickly. In 2007, nearly three-quarters of employers were certain they'd still be offering an employer plan a decade down the road, according to Towers Watson. By 2014, just one-quarter felt the same way. As for Social Security, pundits may believe it's here for the long term; individuals not so much. According to AARP, 57 percent of people are not confident in the future of the program (unfortunate, since 80 percent say they'll rely on it for income).

The extra financial responsibility we're being asked to shoulder wouldn't be as much of a problem if it came with an instruction manual. It doesn't. In 2016, only 20 states require high school students to take a course in economics, according to the Council for Economic Education—that's two fewer than had the requirement in 2014. Just 17 states mandate personal finance. It would be nice to think that parents could simply pass their financial smarts onto their own children. That's not happening in a world where 40 percent of Americans consistently give themselves a grade of C, D, or F when it comes to their personal finances, according to the annual Consumer Financial Literacy

Survey. Is it any wonder that the leading cause of stress among American adults is—you guessed it—money?

I like to tell people I've had a ringside seat at the personal finance revolution. For the past two and a half decades—from my perches at *Forbes*, SmartMoney, *Money*, and the *Today* show—I've chronicled how Americans make their money, save it, spend it, invest it, and protect it. I've examined not just the technical side of personal finance, but the behavioral and emotional components, repeatedly asking: Why do we do things with our money we know are not in our own best interest? More importantly, how do we stop?

Advice—good advice, holistic advice—is a big part of the answer.

To understand why, think about three facts of modern life. One: We are starved for time. Working Americans (particularly those who are either working parents or—like many of your clients—have demanding jobs, or both) will tell you they don't have time to do the things they want. And when they choose how to allocate their limited time off, there are a whole bunch of line items that rank a lot higher than rebalancing their portfolios. Two: The immediate gratification itch that lords over everything from how we shop (ahem, Amazon Prime) to how we watch our favorite shows (cough, Roku) plays a role in our finances, too. We don't come for financial advice just because. We seek it because we have an issue—we're getting married, having a baby, turning 50, getting divorced—and then we don't just need help, we need it *now*. And three: The financial landscape is getting more complicated every year. It's not just that there are thousands of investments (8,000-plus mutual funds, 1,600-plus ETFs) to choose from. It's that the problems we are being asked to solve have multiplied. For years, personal finance publications preached one main thing: Grow your nest egg. Now we have to turn the puzzle on its head and make the money last.

Unfortunately, all of those things stand squarely in the way of doing a good job with your money. Surveys that show Americans are spending more time planning a vacation than retirement, or that we'd rather go to the dentist than spend an equal amount of time learning about money may have been fielded to garner splashy headlines. But they make a point. On the whole, many of us don't put the time we should into our finances. And when we do turn to our money, it's often in the wrong frame of mind—because we've had an emergency or because the markets are down big. When we're emotional, we're not rational, particularly where large sums of money are concerned. That makes it especially difficult to wrap your brain around issues where there are no right answers to complex questions: How long *are* you going to live? How long *will* you be able to work? How much money *will* you actually need year in and year out?

Enter *The Essential Advisor.* As you read the book Bill and Jay have thoughtfully put together, you'll understand why I believe financial advisors have never been more important—and why I believe advice is worth paying for. There's no question that there are plenty of tools available for DIY investors; many of them are excellent. What is in doubt is how many people will actually use those tools. Your portfolio is no different from your lawn in that regard. If you're not going to mow it yourself, it still has to be done. Paying someone to do it for you is much saner than letting the grass become an eyesore. In the case of your portfolio, it also happens to be profitable. ROA—or Return On Advice—is something you can quantify.

Envestnet's study of ROA (tested on thousands of advisors) shows advisors have the potential to add 3 percent in value to their clients annually. Some of the added value comes from investment selection and asset allocation, some from systematic rebalancing and targeted tax management. But I believe the biggest benefit comes from simply having a plan designed to help you get from where you are today to where you want to go tomorrow—and a trusted advisor on your team to help you stay on course.

Which brings me back to January 2016. As I blogged and tweeted and reported on the ongoing rollercoaster in the markets, I took the time to check in with my own financial advisor. Many people are surprised to hear that I have one. But I have for years, for the same reasons I believe others should, and it's a relationship I value tremendously. I shot off a quick e-mail with the subject line: *Yikes.* "I guess after a six-year bull market this is what we get. Anything special you're doing over there?" The return came back in momentarily. "Meeting/talking with lots of clients, and never fun, but fundamentally staying the course, as usual." He signed off with a promise that I'd receive a call shortly.

Then I did.

Jean Chatzky
February 2016

Preface

Naming a book is more challenging than one would think. Our goal in picking the title was to make our point of view perfectly clear: we believe the advisor is *essential* now and into the future in helping more consumers reach their goals and achieve their dreams. Consumers need more advice, not less. This book will most likely be read by advisors who want to continue making themselves essential to delivering better outcomes for their current and prospective clients. However, we believe consumers will benefit from reading it because we also focus on understanding what advisors do, how they deliver better results for consumers, and how consumers should think about the industry and selecting an advisor.

We have day jobs, and understanding what we do in them is important to understanding the approach for this book and our perspectives. Bill is the cofounder and president of Envestnet and Jay is the managing director of Strategic Initiatives and Thought Leadership at Envestnet, where he focuses on advisor training, innovation, and consulting. Envestnet was founded to provide end-to-end technology and consulting solutions to independent financial advisors. At Envestnet, we are solely focused on helping advisors and financial institutions bring better outcomes and financial wellness to their clients. At a time when some are questioning whether financial advisors will be relevant 10 years from now, we believe they will not only be relevant, but more relevant than they are today. Advisors change lives. Investable assets aren't numbers on a page. Investable assets are deferred spending accounts. Investing is an action of trust and hope—trusting the assets will someday be used for something good. When an investor spends their savings to attain a goal, that's where joy happens. This goal may be retirement, a vacation, taking care of a loved one, or sending a child to their dream college. Better financial advice means better lives.

When we talked to our friend Rob Densen, founder of the advocacy marketing company Tiller, about the book, he cautioned us to make sure we don't look like "homers" . . . a sports reference for a fan that roots for their home team so passionately that the team can do no wrong. The fans are blinded from reality by their passion. He cautioned us not to do the same for our industry, our company, and advisors in general. His point was a good one. Others cautioned us not to do it at all, not to have strong opinions about the industry. We serve more than 42,000 advisors today and there's some potential risk in us writing this book because, in some ways, we are critical of some aspects of the industry and how it's been built. As an industry, we aren't perfect. As a company, we aren't perfect. The advisory community isn't perfect. Nobody expects anyone to be so. We hope this book provides a view forward to an evolving industry and serves as a driving force for all of us to continue to push ourselves to become better for our clients.

As a backup to ensure the reader also knows our opinions are independent, we are lucky to have Pam Krueger partnering with us on this effort. We know advisors. We know how they operate and how they should for the future. However, until recently, as a company and as people, we've spent little time thinking about the end investor. As a Gracie Award–winning host of the Emmy Award–winning PBS show *MoneyTrack*, which focused on helping end consumers make better financial decisions, Pam has listened to thousands of consumers. She kept us honest in this effort by helping us to view our industry through the lens of those we are trying to attract to it, as clients and future generations of financial services leaders. You will see a consumer perspective section at the end of each chapter. We believe this effort will not only provide an important voice, but also help achieve a goal of the book: to bring the consumers and advisors closer together.

Although we sit on the same side of the table as the financial advisors and enterprises we serve, as a company we pride ourselves on being independent. We understand there are a lot of different models out there to deliver advice. Some models are arguably better than others, but as long as the consumer is getting nonconflicted advice, then we believe our industry has achieved its purpose.

When we set out on the journey to write this book, we had three objectives: have fun, write something that adds to the industry conversation in a constructive way, and bring the consumer and advisor closer together without being too academic or preachy. We certainly had fun in this effort. Whether we achieved our other two goals is for the readers to decide. We hope we meet your needs. Enjoy the book.

Bill Crager and Jay Hummel

Acknowledgments

We are both avid sports fans. Writing a book is a lot like being an athlete on a team. The athletes on the field tend to get most or all of the credit even though there are dozens of people supporting the victories. Our names are on the cover and we will get a lot of credit for what we hope the readers consider was a victory. However, this was a huge team effort. First and foremost, thanks to three key collaborators in this effort: Jean Chatzky, Les Abromovitz, and Pam Krueger. Jean wrote an outstanding Foreword and is the type of financial advocate the investing population needs in this world. Les drafted and edited much of this book, making the ideas that always sounded good in our heads sound much better on paper. Pam brought her consumer insights to the book, helping us meet our goal of bridging the advisor and consumer gap. We believe her consumer perspectives throughout this effort will prove to be invaluable to the reader. We are indebted to the three of you for your efforts. A special thanks also to those who subjected themselves to our probing questions through their interviews. Please see the biographies of the outstanding individuals who agreed to do interviews and be included in this effort in the back of the book. We are honored you came along for the ride.

We want to thank our families who support our crazy schedules and all that we do. Our wives, Kathy and Valerie, are outstanding partners. Our kids help us stay focused on what really matters in life.

We are lucky to have outstanding colleagues at Envestnet. We have over 2,000 employees who work tirelessly each and every day to help our clients achieve their goals and remain focused on the audacious goal of not only being the best company *in* the financial services industry, but the best *for* the industry. We hope our colleagues believe our efforts here are as excellent as their teamwork. Some colleagues went above and beyond to support this effort. We owe a big thank you to Karen Lanzetta, Cindy Siegel, and Jaime Hernandez. Thanks to our CEO and friend, Jud Bergman, for writing an outstanding strategic piece you will find at the end of the book in a section entitled "The Last

Word." His strategic vision herein and at our company is contagious. Thanks to Rob Densen and "Team Tiller" for coming up with the title of the book.

Lastly, thanks to our amazing clients who give us the opportunity to serve them and gain insights about their businesses, which served as the foundation of this book. Without you, this book would not exist. We look forward to building many success stories and memories with you in the times ahead.

Contents

CHAPTER 1
The Evolution of Financial Advice

You can't connect the dots looking forward; you can only connect them looking backwards. So you have to trust that the dots will somehow connect in your future.

—Steve Jobs

Advice is essential for people to reach their financial goals and dreams. Technology has made it so much easier for consumers to access information, and it is important for advisors to recognize how this impacts their role—for better and for worse. As consumers think about their changing demands, and as advisors position themselves for the future, both groups must understand how drastically the financial system has evolved. It's easy to forget that not long ago the financial landscape was very different. For example, we take for granted the number of transactions we can handle on our phones. Even 10 years ago the thought of moving money with the swipe of a finger or depositing a check by taking a picture seemed crazy.

In the broad history of our industry, the 1950s wasn't that long ago. During that time, when consumers had a few dollars to put away, they opened a savings account. At some savings and loans (S&Ls), the teller wrote down the amount of the deposit in the saver's bankbook along with any interest that had accrued. In time, computers took over many of these tasks, and the economy started to become more global. In the 1980s and 1990s, banks focused on geographic expansion, entering new markets and building more—and larger—branches. Less than a decade later, the amount of traffic into most retail branches declined sharply. Today, few people visit a brick-and-mortar branch to do their banking. Many banks, especially those with a regional focus, are trying to shutter as many locations as possible, a trend driven largely by the rise of ATM transactions.

The first ATM in the United States appeared sometime in the late 1960s. By 1980, the number of monthly ATM transactions was nearly 100 million. Within 10 years that number grew to almost 500 million transactions per month.[1] This accelerated a strategic change for banking executives. In 20 years, banks went from adding real estate to decreasing real estate—an amazing transformation in a sector that remains the heart of the financial services industry. In the remaining branches, there is also a tighter focus on generating revenue through the sale of specialized products and services that often have higher margins. There are also far fewer tellers than in the past, and it is not uncommon for them to encourage customers to bank online and through mobile channels.

This short trip down memory lane was intentional. Banking is the largest portion of the financial services industry and these rapid changes impacted its employees and clients. In the wake of such significant change to the industry's biggest sector, it's reasonable to believe that the wealth management and advisory businesses will face similar disruption in the very near future. Those opportunities and challenges exist today and will accelerate for advisors.

THE ROOTS OF MODERN INVESTING

The majority of this book is about the future. Our goal is to present a roadmap for increased success in a period of immense change. In order to do so, we believe it is crucial to examine the past. After all, these events have set up where we are today and represent the building blocks

[1] Michael Quint. "Citibank Joins Teller Network," *New York Times*, February 16, 1991, www.nytimes.com/1991/02/16/business/company-news-citibank-joins-teller-network.html.

of the future. In the 1950s, most people in the United States shunned investing. Many of them had lived through the Great Depression and wanted no part of the stock market. A number of Americans subscribed to the notion that the stock market was for rich people, and this perception had become a reality. Buying and selling securities was costly, in large part because most brokerage firms charged fixed commissions, which were quite high and typically nonnegotiable. These rates could be 10 percent or more of the transaction amount. In 1952, only 6.5 million Americans, which was about 4.2 percent of the U.S. population, owned stock.[2]

In the 1970s and 1980s, consumers typically looked to brokers for what they deemed to be financial "advice." Madison Avenue helped broker-dealers convey that message to consumers through advertising. One of the most famous commercials of all time was for the brokerage firm, E. F. Hutton. In one commercial, wealthy people were filmed as they lounged around a swimming pool at what appears to be a country club or a fancy hotel. A man turns to a woman and asks about her broker's advice. She answers casually, "Well my broker is E. F. Hutton, and E. F. Hutton says . . ." Everyone around the pool stops talking, purportedly because they want to hear E. F. Hutton's financial advice.

Advertising campaigns like E. F. Hutton's were built on the premise that a brokerage firm could give investors tips on what securities products to buy. Since that campaign, the firm has disappeared through a series of acquisitions involving Smith Barney, Morgan Stanley, and Citigroup. (E. F. Hutton's grandson has launched a new, unrelated company under the old name.) But many people remember the slogan that made E. F. Hutton famous, "When E. F. Hutton talks, people listen." *Money* magazine describes, on its website, how effective the campaign was during the bull market that began in 1982:

> This was a powerful image during the bull market that started in 1982. After the lost decade of the 1970s, investors were getting excited about stocks again. The

[2] "Stocks Then And Now: 1950s And 1970s," Investopedia, October 1, 2008, www.investopedia.com/articles/stocks/09/stocks-1950s-1970s.asp?layout=orig.

> Hutton ad suggested that only through a broker could you gain an investing edge.
>
> In some ways, the suggestion was ironic—coming just ahead of the massive insider trading scandals of the late 1980s, when dozens of Wall Street players, including Ivan Boesky and Michael Milken, were found to have skirted the rules for their own advantage. So much for the broker edge, which in those cases anyway was about illegal stock tips sometimes in exchange for suitcases full of cash.[3]

During that same era, Smith Barney launched an equally memorable ad campaign. Distinguished actor John Houseman voiced the immortal slogan: "Smith Barney. They make money the old-fashioned way: They earn it." It's worth revisiting these advertisements because they capture what the world of financial advice was like in the 1970s and 1980s. And they also reflect how consumers perceived it. These campaigns strongly tied financial advisors to the wealthy classes, and perpetuated the mystique of investment firms. That approach was quite different from what you see today in television commercials for established firms, and in taxi-cab ads for new players like Wealthfront and Betterment.

Firms also operate much differently now. Up until the late 1980s, if you were a broker, you attended a daily research call where stock ideas were discussed. These research calls gave brokers ideas for how to help their clients buy and sell securities. Brokers were allowed to promote only those stocks on which there was research coverage. There's a debate as to why this happened. Some would argue it was to manage risk, as recommended securities should be tracked, but others with a more jaded view argue it was to push the securities with higher commissions or with companies with financial ties to the brokerage firm. The investment business was largely product focused. It was an era when brokers pushed stocks touted by research analysts.

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[3] "Shhh . . . E.F. Hutton Is Talking Again," *Money*, March 19, 2015, http://time.com/money/3751675/ef-hutton-gateway/.

REGULATORY AND TAX CHANGES SPUR EVOLUTION

In 1975, the Securities and Exchange Commission (SEC) made an important decision that laid the path for the financial world as we know it today. Fixed commissions were abolished. Up until what is known as "May Day," brokerage firms charged commissions based on a schedule published by the New York Stock Exchange. The commission was calculated off a grid based on the number of shares traded. Brokerage firms, therefore, could not compete with each other on price. The new regulations created a situation where commissions could now be negotiated. This decision opened the way for discount brokers, and eventually led to the online trading craze of the 1990s. Fueled by enhanced technology, online trading allowed people to cheaply buy their favorite stocks on their own, without a broker, for the first time.

The next change came in 1978, three years after fixed commissions were abolished. A major change to the tax code opened the door to an entirely new financial services sector. Congress added Section 401, under which Item K allowed companies to offer their employees an additional benefit, now known as the 401(k) retirement savings plan. 401(k)s and similar defined contribution plans helped turn employees from spenders into savers—and investors.

401(k) retirement savings plans took off in the 1980s around the same time that companies began to sunset traditional pensions. The vast majority of defined contribution plans were offered by larger companies as one of the benefits to retain employees and also encourage saving. A key inducement was the employer match, a 401(k) contribution made by the employer at no cost to the employee.

Despite the potential benefits of 401(k) plans, they also presented employers with new challenges. Most companies had no idea how to determine which investments should go into these plans, so they turned to 401(k) record-keeping firms to administer their plans. Most of these firms were units of large mutual fund companies so, not surprisingly, the investment menu consisted of a good range of mutual funds. (The default option was the money market fund, much like today's default option would be a target date fund.) This represented a key building block for the future because the 401(k) business supported the enormous growth of the mutual fund industry.