Ep117: Major Wealth Management Trends

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My name is Keith Matthews, and I'm joined by my co-host, Marcelo Taboada. Marcelo, how are you today?

Marcelo: Keith, I'm doing good. I'm excited about today's show. It's a nice show that compliments the one we did last week.

Keith: Yeah. Last week we did one on the landscape of Canadian retirement and it was very well received by listeners. Today's show is going to be on the four major global trends in wealth management.

Marcelo: Yeah.

Keith: We've identified four trends that I think are interesting for us to review, but more importantly, the implications for our listeners and the implications for Canadian investors at large. So, the four trends are as follows. Trend number one, the rise of index funds globally. Trend two, the rise of independent firms. Trend three, the rise of retirement planning. And trend four, the rise of investor protection and or investor transparency. All right, so, Marcel, why are we having first, first of all, why are we having a discussion on major trends? What's important about this?

Marcelo: I think it's important because, as Canadians are navigating their finances. And people in the world, the trends have an impact in how people make decisions about money. And if you're aware of these things, it leads to making better decisions, essentially.

Keith: Yeah, absolutely. Having more awareness on what the major trends are, what are the major movements within an industry that serves you, is empowering. It allows the investor to make better decisions about who they hire. What kind of services they want to use and how they actually, bring wealth management into their lives.

Marcelo: And it leads to better outcomes overall.

Keith: A hundred percent. Alright, let's jump right into it. The very first trend that we've seen that we want to talk about is…

Marcelo: The rise of the index fund. So, index funds in the United States 25 years ago, for every dollar that went into an index fund, $5 went to an actively managed portfolio where you're paying a manager to beat the market, that trend is completely different now. Now more money is going into index fund than it is to active funds. So, if you look at the distribution right now in the United States, 60% of all money managed is in an index fund

Keith: in any type of index fund. Now that could be an index fund that tracks the S&P 500. It could be an index fund that tracks international securities. Could be something that tracks the bond market regardless. It's not actively managed strategies.

Marcelo: Correct. It's taking over now, and it is happening globally as well.

Keith: So, when you say globally, we know that it's happening in Europe. We know that it's happening in Asia. There is one country where index money management hasn't taken over active money management. What country is that?

Marcelo: Canada.

Keith: Canada. All right, let's talk about why it's not happening and then the good news as to what investors can do.

Marcelo: Yes, so I think the biggest reason why this is happening in Canada is because you have five major financial institutions that control the manufacturing and distribution of actively managed funds.

When the average Canadian walks into a retail branch, their money is invested into a mutual fund that probably is actively managed and has higher fees.

Keith: It’s the lack of independence and it's the control by manufacturers which essentially is pushing, and they're sort of creating a moat, and they want to keep all their fees high and their profits high.

Marcelo, tell us a little bit about the management fees that we find around the world.

Marcelo: this is the other imbalance that we're seeing in Canada if you look at, the global average for management expense ratios of mutual funds, it is about 1.3 globally. In the US is 0.4 in Canada is 2% to 2.25%. So, we have significantly higher fees than the rest of the world.

Keith: Yeah. And part of that might be advice embedded in that but at the end of the day, Canada's known for a high fee world. And that comes with active management primarily because the large financial institutions, whether it's insurance companies or banks, are protecting their profit margin by pushing their high fee strategies. This is one of the reasons why index management hasn't accelerated quite as fast as the rest of the world. That said, the tide is turning for Canadians. The optimistic thing now is that Canadians are way more aware that index funds are available and there are way more independent firms now using index funds. We've been using index funds for 25 to 30 years. Now there's way more firms doing this, which is fantastic. And the awareness level amongst individual investors is very high.

Marcelo: It's way higher and the implications for Canadians are if you're in a high fee product that underperforms and it's all over the place with no advice, it can mean delayed retirement days for people, because you're paying higher fees it's a drag on your plan and your investments, and it also reduces retirement lifestyle spending when you're retired. More fees, less money in your pocket.

Keith: Well put. I used to remember trying to explain what's the impact? And most people would say, well, you know, it's a little bit more in fees, I don't mind. But the reality of it is you should mind. You should mind because it does affect everything you've just mentioned.

Marcelo: Investing is probably the only industry where you pay a lot of money and people don't get upset that they're not getting the results they need to be getting. Because if you think about any other industry, if I'm paying a lawyer and I'm not getting any value, I'm raising my voice for sure.

Keith: Many other scenarios suggest that when you pay higher for a suit, you're going to have higher quality suit. And people don't necessarily realize when you pay higher fees, you don't necessarily get a better outcome.

Marcelo: Yeah.

Keith: So, what's happening though, I think from this major trend is the world is recognizing the power of the index funds.

Marcelo: Yeah.

Keith: And this is not a 20-year story. This is a 50-to-60-year story that is accelerating. That acceleration is coming to Canada as well.

Marcelo: Yeah, and the evidence is combination of things. You have academic evidence; you have institutions that publish research every year that shows that indexing is a much better approach to investing. And you have even houses like Morningstar publishing reports all the time. The awareness is just way higher now.

Keith: Yeah. the good news for investors is it's here in Canada, it's growing around the world, and they should, if they're looking at their investment portfolios or who they should choose, they should make sure they understand if this is a viable option, if it makes sense for them and if they need to explore that more.

Marcelo: A hundred percent.

Keith: Okay. let's go to trend number two, the rise of independent firms.

Marcelo: Yeah. So, what we're seeing here is something similar to, the rise of the index fund. If we look at 25 years ago, most money in the United. States was managed in large institutions. Think about Goldman Sachs, Merrill Lynch, the Lehman Brothers, some of those collapsed in 2008, but think about the big US banks. In Canada, the equivalence will be the Big five banks. Right now, in the United States, more money's being managed by registered investment advisors, which are independent firms that are client-centric, instead of product centric, and they offer many different services.

Like they could offer tax planning, they could offer tax services, they could offer financial planning and things like this. So that's another trend that we're seeing. And right now, most money in the United States is managed by. registered independent advisors.

Keith: I was surprised to see these numbers, because what we're looking at to our listeners is a chart which essentially shows that 20 years ago, five times as much money was being managed by large wire houses, large brokerage houses, versus independent RIAs. Now, fast forward to 2024. there's approximately $10 trillion managed by RIA firms and $8 trillion managed by the large wire houses. The independent has overtaken the wire house in the United States. And we're seeing this in other parts of the world as well.

Marcelo: Yeah.

Keith: In Australia, in Great Britain, in other parts of Europe, these trends of independent, advisors are pushing forward. We're now starting to see it in Canada.

It's a very interesting concept, the RIA, Registered Investment Advisory firm, and that in the United States is a group that is allowed to advise clients, Produce strategies, best interest strategies for clients. They are not allowed to receive commissions. And they typically, they're not building products, which then get resold by other institutions.

Marcelo: They're client-centric instead of product centric. It's a very simple proposition.

Keith: We are the equivalent of an RIA firm in Canada, being we're licensed as a PM firm. The major distinction for the independent firm is they're not building product. As soon as you build product, you're always trying to find ways to market product, even if it may not be the best product.

Marcelo: Correct.

Keith: So, the rise of independence, I'm telling you that we see this more from individuals that we speak to, where they're coming in and they're saying, I don't want to work with a firm that has an agenda, that's not my agenda, that's not working in my best interest. So, what are some of the research or some of the…, there's been some recent investigative reports by CBC as well as the OSC. Let's talk about a little bit about that because that ties into Canadians becoming aware of some of the conflicts that are embedded in a sales culture.

Marcelo: CBC runs this program called Marketplace where they go with hidden cameras to explore and do investigations on different, products and service providers. And they did one with the major banks. And they realized on camera that a lot of people were giving false advice around fees, products, advice, such as, there was a lady that walks in with an inheritance.

Obviously these are mystery shoppers, right? So, they walk in with an inheritance, and they say something like, Hey, should I pay out my credit card or invest my money? And the banker goes. You should invest the money. Don't worry about the credit card debt, which is ludicrous, right? Like you're leaving a debt that charges 21% and you're going to get what, 5,6, 7% at best in an investment.

They found very problematic things such as disclosing fees, like they say oh, don't worry about the fees, they take care of themselves, things like that. It shed a lot of light into the practices of the banks. I used to work at a bank so I know how it is, you find very good people, but you're in an environment where the incentives are set up for you to sell products, not to act in the client's best interest and a lot of people, like myself, end up leaving and becoming great advisors. So, it's not that bad people are working in those places, it's the incentive structure that is bad.

Keith: What they've highlighted is a sales culture.

Marcelo: Correct. It's a sales culture.

Keith: And when you get to independent firms that have to operate with more of a fiduciary responsibility, It's different. It changes the culture immediately. Canadians are becoming more aware that this actually matters. Within our industry a lot of people have pointed to the CBC marketplace report. It shed light that there's a major sales culture with major incentives and these incentives do not always produce the best results for clients. So, with that investigative report, there was another one that came through, and this to me is actually the more interesting one. And that was done by the Ontario Securities Commission. They saw the report and they said, we're going to go do our own report. And so, they surveyed financial advisors or mutual fund representatives at the branch level. And what was your major finding?

Marcelo: the major finding was that 25% of them believe that they're not working in the client's best interest, essentially.

Keith: Yeah. So, this report is entitled “Sales Culture Concerns at Five of Canada's Bank affiliated dealers”.

And on the executive summary, the number one point that they've brought out was this point that you've mentioned, which is most, a quarter, don't feel that they're working in the best interest of the client. They found about 20 others; they did a lot of different work. But this was really, the big one that they walked away with.

And so, what does all this mean for advice?

Marcelo: It means that now that we know all these things, and we are seeing a trend, the good thing is that it means that people have better choices now. In Canada, we're seeing a rise of independent firms like ours. you're seeing that more in the market and that leads to better outcomes, because I think Canadians, 20 years ago, maybe they didn't have that many choices outside of a bank.

Keith: Those are all very valid points. In fact, to me, what a lot of this also does is it allows Canadians to become way more aware. We've always been aware. Look, you were aware when you made a decision, to leave large banking and come into this space that is here, this client driven.

I was aware many years ago when I left institutional bond trading and went to my former firm, PWO Capital, it was based on a world which was transparent, client driven, advice, wealth management and portfolio structure, and not the selling of products. So, within the industry we've become aware of this, but now I think more and more Canadians are becoming aware of this.

Marcelo: that's the big one.

Keith: So, implications for our clients. The fact that this trend is now existing in more independent advisors and independent firms. What are the implications?

Marcelo: There's better choices. Lower fees, better client service, better outcomes.

Keith: A lot of the trends we're talking about in today's show are very positive for our listeners and very positive for investors at large.

Marcelo: Yep. the implication is clear, if clients end up in a client-centric environment, where they're getting good advice, an investment approach that works and lowers fees, it leads to better outcomes.

Keith: OK, Trend number three, Marcelo?

Marcelo: the rise of retirement planning. Bottom line, Keith, is we have an aging population. People are living longer, and there's way fewer defined benefit plans. So long gone are the days where you would have an investment advisor that only talks about investments.

People now need a proper retirement plan, and that is a trend we're seeing in the industry. It's a trend we're seeing worldwide, and it has major implications for Canadians because if you do not plan for your retirement, it will lead to bad outcomes, and you do not want to be in that situation.

Keith: For sure. we did a show last week where we highlighted the direction of the Canadian demographics in terms of how many people are either pre-retirees or retirees. 25 years ago, one in seven was a retiree, 65 and over. Now it's one in five, and in 10 years from now, it'll be one in four.

If we add pre-retirees to that category in 10 years from now, it's going to be like one in three, one in 3½ is pre-retired. That is a massive amount of people who need and want some form of retirement planning,

Marcelo: they need to answer the basic questions: “Am I going to be okay? What happens if something happens to me? What happens to my spouse? do I have a proper legacy plan? Is my estate plan in place?”

These are important questions. It's a rising trend and people need to get on with it.

Keith: Yeah, and the good news is more and more firms, and we see this across the Canadian landscape, more and more firms are offering retirement planning.

Marcelo: Correct.

Keith: I think one of the implications for investors here is if you're reviewing your structure, your financial affairs, and you're not receiving financial projections about your retirement, and planning on your retirement, you really should seek more advice. Because it’s available, a lot of firms are offering it.

Marcelo: Yes.

Keith: And I think what you'll see is you'll start to see a distinction within firms that are offering as to what is really thorough planning and what is average planning. And I think Canadians are going to become more aware of this. Individuals we'll talk to each other, it's just natural, for this to happen.

So that was trend number three, Marcelo trend number four, the rise of investor protection in Canada. So, the background behind that is a structure called CRM, and these are the regulators, national regulators that regulate mutual fund dealers, security dealers, and portfolio management firms.

They came over with a series of reforms and they had three major reforms, the first two are in history. They happened in the past. And the third one, we'll spend a bit more time on, is coming next year. Let's start with the first two and then share with our listeners what the third one is.

Marcelo: So, the client relationship model, like you mentioned, aims to shed light in transparency, fee disclosure, and client protection. The three stages were as follows: The CRM one stage was pre-2014, and that was basic disclosure at onboarding, they would disclose fees and very basic information, and it wasn't kept ongoing after that.

CRM two tried to change that from 2014 to 2017, the new stage was annual performance. Reports had to be given to the client every year, and annual compensation on investment management fees had to be reported to the client in dollar terms instead of percentage.

Keith: It was advice fees, correct?

Marcelo: Yeah, advice fees. Not if you had a relationship with an advisor that had two layers of fees of investment management and one, management expense ratio of whatever product, that wasn't disclosed. So, there was just one element disclosed. Now, CRM three will have for the first time total cost reporting on everything. So, Canadians will for the first time, see everything of all they're paying and the services they're receiving.

Keith: So, what they're going to get is they're going to get a statement with total cost. So, if you're paying an advisor and your advisor is using an ETF, the ETF charge will also be noted.

Marcelo: Correct. Or a mutual fund.

Keith: Or a mutual fund and the amount of money, dollars, associated with the cost of that strategy. Annual dollars. It also means that if you're working at a bank that historically you may not have had an advisor, but they're using a mutual fund …

Marcelo: that just has an MER embedded…

Keith: that just has an MER of 1.9%, you're going to be shown 1.9% in dollar terms. What the regulators are trying to do is create an environment, I think it's actually reasonably smart, it's a lot of work for firms to do, but they're trying to create an environment where Consumers can make proper choices.

Marcelo: Yes.

Keith: Educated choices. So now a consumer can understand what services are being provided. I'm getting planning, I'm getting portfolio, I get a chance to call, somebody helps me with my wills on occasion, this service, that service gets done. What they could never quite figure out was how much were they paying for all the services?

So now they're actually for the first time, going to get all of the, what do I get? What do I pay? And they'll be able to make better choices, and better decisions. And that's the issue. I think that's a pretty major amount of transparency that's going to come at Canadians very quickly.

Marcelo: Correct.

Keith: And empower them, to help them, make better decisions. Marcelo let's wrap up today's show we've got four, there's more trends going on in the investment industry. There are trends that are out there that we don't necessarily feel are trends that you need to be aware of to really improve your situation.

We thought we'd choose four really solid trends. What's your takeaway here? What's your final words of advice?

Marcelo: My takeaway is one of optimism. I think all these four trends are positive and will lead to better outcomes for Canadians. I define a better outcome by having a better approach, having peace of mind and a happy retirement where you can have the best life that you can have.

Keith: Wow. We should just wrap the show up right there. That's fantastic. Thank you, that's very well put. The only thing I would add is, you're right, we are optimistic. These are great trends.

This is empowering. This provides Canadians with better opportunities to make decisions. Better outcomes to me mean less stress, better returns. Better returns, better advice. And if all of that can get them to their goals faster in a smoother environment, better for everybody. So, I think it's a wonderful time to be an investor right now.

So with that Marcelo, thank you so much. To our listeners, thank you for tuning in. We hope you find this information informative, and we look forward to the next show.

Marcelo: Thank you so much!

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