Spring Conference Marks Latest Breakpoint in the Evolution of the Industry

The Department of Labor final fiduciary rule dropped on Wednesday, April 6, less than a week after we wrapped up our 2016 Private Advisor Group Spring Conference. The new regulation, designed to reduce conflicts of interest for advisors who work in the 401(k) and individual retirement accounts space, redefines the threshold at which investment recommendations will be held to a fiduciary standard. The final rule promises to have a significant impact on the financial services industry, requiring financial advisors to restructure their client relationships and adapt to the new compliance environment. In short: advisors must evolve or be left behind.

It was no coincidence that we chose Evolve: Partners in Progress as the theme of our Spring Conference. In our efforts to support you and your advisory practice, the breadth and depth of our support services are evolving. Change is the only constant in this industry, and our job is to anticipate that change and provide resources that minimize disruption so that you can continue to focus on your clients. Taking place from March 29 to 31 at The Borgata Hotel Casino & Spa in Atlantic City, the Spring Conference brought together 231 advisors, 88 Strategic Partners, 12 LPL Financial representatives and 14 professionals from the PAG home office to collaborate on the issues that are driving this change.

With the help of our Strategic Partners, we put together a robust lineup of speakers and breakout sessions. In addition to a special focus on the imminent DOL ruling, topics included investment products and solutions, new ways to capture and retain assets, best practices for compensation and adaptation through technology. Advisors took advantage of Study Groups, as well as more informal gatherings during breaks in the agenda, to come together to share ideas. The most important aspect of our conference series is this opportunity to explore the various pathways to success represented by the Private Advisor Group community and learn from each other. We continue to learn from you, and your feedback is what allows us to add value to our partnership and continuously progress.
Continuing the tradition, Managing Director Pat Sullivan opened the Spring Conference by providing an overview of where Private Advisor Group finds itself today and how we will continue to evolve services around our four cornerstone initiatives: compliance, growth, operational support and advocacy.

**Compliance: New Regulation on the Near Horizon**

The DOL fiduciary rule will require advisors to fundamentally change the way that they do business. PAG is fully prepared to assist you in meeting compliance demands set in motion by the new regulations. On the advisory side, this will likely mean resetting things with your clients as the SEC fiduciary standard is upgraded to the ERISA fiduciary’s standard. Conflicts of interest will need to be removed, advisory fees reconsidered and accounts restructured. In other news, the SEC evaluation of the PAG home office continues, and the agency has announced that it plans to come out with its own rule later this year.

**Growth: Organic, By Acquisition and through New Opportunities**

On the growth front, we have several exciting initiatives to help you scale up and expand your book of business. The Actifi Client Engagement Program is a great opportunity to leverage your existing resources to achieve organic growth. The PAG discounted rate of $1,595 is fully refundable if you do not grow your business by at least 30%. We also offer a turn-key marketing program for advisors who want to grow their practices through acquisition or external recruiting. Finally, we encourage you to take advantage of the PAG Internship Program. It’s a great time to add a fully trained, BranchNet-certified intern to your office, and delegate those pesky administrative tasks so you can focus on growing your practice.

**Operational Support: Advancing Service Levels through Technology**

Our partnership with the LPL Financial Service Operations team continues to pay dividends, as we have seen a 54% improvement in the average speed to answer calls. LPL continues to push the technology envelope, with the goal of reaching 85% of processes fully automated. Automation through technology is also a worthy goal for your own practices. Leveraging tools such as Move Money and AccountView will provide your clients with an integrated service experience. Keep in mind, these are perfect projects for a summer intern!

**Advocacy: Getting Our Voice Heard on the Hill**

Some of our advocacy efforts are focused through the LPL Financial Political Action Committee. The mission of the LPL PAC is to be a voice for you in Washington. There is certainly to be more regulation coming down the pike, and your interests and concerns must have a seat at the table. If you are an LPL shareholder, we urge you to contribute by joining the cause. More members mean more dollars, and more dollars mean more power on the Hill. You can sign up online. Go to http://www.lplgovernmentrelations.com and click on “Join the PAC”.

Additional advocacy efforts have been focused on protecting you and your business. Hybrid advisors should be aware that PAG has leveraged our scale to bring you a new E&O buy down solution. Since LPL’s new plan requires you to pay $20,000 if you are named and leveraged our scale to bring you a new E&O buy down solution. Since LPL’s new plan requires you to pay $20,000 if you are named and $50,000 if you and LPL are both named, we shopped around to bring you a deductible that is only $2,000 if you are named and $5,000 if you and LPL are named. This comes to you at a cost of only $100 per quarter billed to commissions, with the ability to opt out.

The Great Debate between active and passive management rages on in the world of investing. The financial media often present these two strategies as competing dogmas, simplifying the complex array of decisions behind portfolio construction into one starkly philosophical question: is it possible to beat the market? In reality, most asset management strategies exist on a spectrum between these two binaries. Guy Adami, Director of Advisor Advocacy for Private Advisor Group, moderated a special session around the question of how financial advisors can balance active and passive management to best serve the needs of their clients. The expert panel comprised Eric Crawley, Assistant Vice President and Asset Allocation Strategist at LPL Financial; Daniel Wallick, Principal at Vanguard; and David Polak, Equity Specialist at American Funds. We have paraphrased their main ideas below.

**What traits are most important to consider when identifying a world-class active manager?**

Eric Crawley: Successful active managers are consistent, process-oriented and disciplined. When selecting a manager, look for a high degree of consistency, both in regards to returns and selection bias. Also ensure that the manager has a robust process in place - capable, defendable and repeatable. Finally, the manager should show discipline by adhering to that process as the market fluctuates.

Daniel Wallick: We built our qualitative assessment around the Four Ps: People, Process, Philosophy and Price. Who is the person, and do we believe in what she is doing? What is her process, and does she consistently stick to that process? What is her philosophy in terms of the services that she delivers? And finally, does the package of person, process and philosophy come at a reasonable price?

**Is there room for both active and passive management in an investor’s portfolio?**

David Polak: These should not be competing orthodoxies. The question is when to use one strategy over the other, and then how to choose the right active manager. The buzz is all about how average active managers consistently fail to beat the benchmarks. We are not looking for the average active manager. An above-average manager combines low costs with a high level of ownership. That’s what we want.

Daniel: Moving beyond theory to practice, you know that it is difficult to convince clients to show patience in the face of downward volatility. The most important role you play is that of behavioral coach. A good coaching strategy would be to start a client off with index funds, then begin the longer conversation about tilting toward opportunities and incorporating active management strategies.

**What are the macro trends that are shaping the financial services industry?**

Eric: Today, access to information is instantaneous, and the volume of that information is vast. Your clients are exposed to the same well of information, and it can be overwhelming to manage their expectations in this environment. Financial advisors must be able to separate the signals from all that noise. The LPL Financial Research Team is a great resource to leverage in your efforts.

David: The immediacy of information has tremendous psychological impact on investors. The crises of 2008 and 2009 are great case studies. Rather than accepting that randomness plays a part in market fluctuations, people were screaming that it was the end of the world. It is crucial not to confuse flows with fundamentals. Financial advisors can serve a purposeful role by mitigating these emotions.
One dog year is equal to seven human years. If your maternal grandfather is light on top, enjoy your Beatles-throbwback mop-top.

We very seldom question it. We notice and seek out evidence that confirms the belief while actively working to discredit evidence that disconfirms it. It’s a vicious cycle where facts are facts only insofar as they support what we already believe to be true. Our beliefs become the truth.

How do we form those beliefs in the first place? Why do we believe what we believe? Here is one scenario: We hear something. We think critically about the information received, weighing the full body of evidence for and against its factualness. We decide if what we heard passes the test. Finally, we form a belief. Sounds logical, but there is a body of research that shows a much different process at work. We hear something. We believe it. End of process.

What’s the remedy?

There is a way out of this belief-formation pattern. Ask yourself: “How much would I bet on my belief?” This simple question moves us away from thinking about our beliefs in absolutes – we are either 100% right or 100% wrong. Our beliefs become probabilistic. We start to make calculations and weigh our confidence: When did I form this belief? What evidence do I have? How reliable is my source? The result is that we are now able to update that belief.

When we process new information with awareness of our confirmation bias, we are improving our ability to make informed decisions. With each improvement, the next decision is made easier. Like compounding interest, we have compounding good decisions. We become better, more flexible thinkers and more believable speakers. Our clients are better served because of it. And when we engage our clients in that process, we can help them to make informed decisions about their financial futures.

Years of experience combining multifactor quantitative models with deep fundamental research has taught Bob Doll that talking about the markets is much more than a bunch of hot air. As Senior Portfolio Manager and Chief Equity Strategist at Nuveen Investments, Bob understands that the money is at the margin. This is a game of inches. To have a good year, investment managers need to get a little more right than wrong. To that end, Bob offered conference attendees his investment outlook for the months ahead.

Ten Predictions for 2016

1. Real and nominal GDP growth will remain modest.
   The U.S. real GDP growth remains below 3%, and the nominal GDP growth below 5%, for an unprecedented tenth year in a row. While job growth remains strong and wage growth is accelerating, consumers are spending selectively and opting to save their surplus to refinance or pay off debt.

2. U.S. Treasury rates will rise and high-yield spreads will fall.
   As the bond bear market enters its fourth year, high-yield bonds are in disequilibrium. Inflation is experiencing crosscurrents from the tightening labor market and the strong dollar. Default rates are below normal and spreads are above normal. As this begins to correct, opportunities may emerge.

3. S&P 500 earnings will make limited headway.
   Advances in consumer spending are partially offset by oil, the strong dollar and rising wages. These factors have delivered a profit recession without an economic recession. The consensus prediction of 9% growth in S&P 500 earnings per share would be the third-highest for this recovery, and likely too high.

4. U.S. equities will experience a percentage change in the single digits.
   That change will likely be in the positive direction, but it depends on what happens with oil and the dollar. We are still in a bull market, but one that is no longer young and vibrant. This bull market has more than a few wrinkles and walks with a cane. Still, stocks remain the asset of choice.

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AND WINGS!

COCKTAILS

GAMES
The 2015 InvestmentNews Adviser Compensation and Staffing Study surveyed 363 advisory firms, each of which provided comprehensive data on their compensation, staffing and management strategies. InvestmentNews Research Analyst Matt Sirinides and Associate Publisher Mark Bruno provided conference attendees with highlights from this bellwether benchmarking study. Here are the top five takeaways from their analysis:

1. **Employee-advisors outnumber owners.** Independence is no longer defined by ownership. Record growth has enabled the typical firm to double in size over the past five years, with non-owner professionals hired at lower levels of compensation in order to leverage the experience and skills of highly paid owners. These non-owner career tracks are becoming better defined and better understood.

2. **Salaries are flat while bonuses are increasing.** Staff growth has not translated into salary growth, which is minimal if existent. This trend especially holds true at the employee-advisor level. Compensation growth has taken the form of increased incentives rather than higher salaries. The shortage of advisors in the industry may be less severe than imagined, as evidenced by demonstrated lack of leverage in salary negotiations.

3. **Owner incomes have reached record levels.** Growth has rewarded the owners of independent advisory firms. The typical advisor-owner earns an average $527,000 in pre-tax income, a significant increase over 2013, when average income totaled $465,000. This is in large part due to the leverage effect described above, where owners are able to delegate revenue responsibility to Lead Advisors.

4. **NextGen advisors are filling important support roles.** A fundamental shift in the makeup of independent advisory firms is underway. With levels of productivity at an all-time high, many firms are hiring additional entry-level advisor associates, and these positions are being filled by NextGen candidates. The data show that firms employing support advisors have higher productivity than those that do not.

5. **Business development is a key requirement for senior staff.** The most profitable firms place a strong emphasis on business development and are more likely to make bringing in new clients a requirement for lead advisors. Top-performing firms are also more likely to build specific incentive compensation programs around new business development in an effort to align an advisor’s career goals with the interests of the firm.

With the announcement of the Department of Labor final fiduciary rule fast approaching and the sun setting on the regulatory status quo, the potential implications of the new rule cast a long shadow across the minds of conference attendees. Private Advisor Group Compliance Director Kevin Sullivan sat down with LPL Financial’s Peggy Ho, Chief of Staff for Legal and Government Relations, in order to shed some light on what advisors can expect from the new compliance environment.

**The Intent**

The DOL is primarily concerned with conflicts of interest that may incentivize an advisor to put an investor in a retirement product that is suitable but more costly than alternatives in order to garner higher revenue from fees. The different standards of care offered by the brokerage and advisory models are not easily understood by investors. The intent of the rule will be to expand the fiduciary standard to cover all investment advice given in retirement accounts, essentially making brokerage compensation illegal apart from exemptions as defined by a Best Interest Contract between the client and advisor.

**The History**

When the fiduciary rule was first proposed in 2010, it was met with intense pushback. Critics claimed that the proposal would destroy choice by eliminating an entire category of how investors receive retirement advice. The pushback was ultimately successful, and the DOL withdrew the rule and went back to the drawing board. A new proposal was issued in 2015, which attempted to address the criticism by introducing the Best Interest Contract exemption, which would in theory allow for the continuation of brokerage advice in the retirement space. However, because compliance is onerous, there is a strong possibility that the final rule will be met with litigation.
5. Stocks will outperform bonds for the fifth year in a row.

If you believe that “this time is different,” then you certainly do not care to look at a 30-year pattern of stocks outperforming bonds when the Fed first raises interest rates. For the rest of us, an asset mix of +5% for stocks, -10% for bonds and +5% for cash is our suggestion for 2016.

6. Non-U.S. equities and fixed income will outperform domestic.

Recent years have seen U.S. markets consistently outperform international markets, calling into question the wisdom of international diversification. However, stabilization in commodity prices, improvements in global growth and trade and the decelerating dollar may cause this relationship to flip.

7. Sectors with the highest free cash flow will outperform the rest.

Information Technology is the clear winner in terms of free cash flow. Other suggested overweights include Financials and Telecommunication Services, which will likely outperform the Energy, Materials and Utilities sectors.

8. The world is not safe, but it is resilient. The market will also be resilient.

Geopolitics, terrorism and cyberattacks continue to haunt investors, but they have very little impact on the financial market. Human societies adjust to new security threats surprisingly quickly, and a bull market in terrorism has only produced temporary market reactions.

9. The end of fiscal austerity will arrive.

The federal budget deficit is the unsung hero of the past 6 years, dropping from 10% to 2.5% of GDP. With both sides of the political aisle rejecting fiscal restraint – Republicans fighting for national defense, Democrats fighting for domestic spending and both fighting for tax credits - this era is over.

10. The winner of the presidential election will be...

Facing serious issues with corporate tax policy. The U.S. continues to have the highest marginal tax rate in the world, and we burden MNCs that bring their profits home with high penalties. Whoever takes a seat in the Oval Office next, Republican or Democrat, should have reform on the agenda.

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**Internship Program**

**FIND A BRANCHNET CERTIFIED INTERN IN YOUR AREA**

Private Advisor Group, in a collaborative effort with LPL Financial, recognizes the need for quality, trained staff in your office from time to time. We are also painfully aware that the average age of an advisor today is mid-50’s, and there is an industry wide challenge finding young talent to enter into the advisory business- leaving few successors for the future of your practice.

In an effort to solve for both of those issues, we have designed an Internship Program for college students across the country.

**FIND AN INTERN TODAY!**

Visit PAG’s Resource Center, KEYWORD: INTERNSHIP PROGRAM to learn more!
We are honored to have the support of our Strategic Partners. Without them, we would not be able to bring you many of the programs and events in place today. Please spend some time perusing the valuable content they have provided on the Resource Center in an effort to help you manage your clients’ assets and run your practices. We thank them for their support.