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The Competitive World of Investment Counselling & Family Offices

Investment practitioners have formed Investment Counselling and multi-Family Offices to distinguish themselves from the products and policies promoted by large banks and investment houses. Their independence was essentially client-focused but, to be fair, was also a reaction to the strictures of working for a large firm. What started out as independent investment advice developed into deeper tax and financial planning advice, providing a more comprehensive platform to manage High Net Worth Capital for individuals and families.

The landscape has changed immensely since the first Family Offices were started almost fifty years ago. Comprehensive investment and wealth management services are now available from a wide range of firms, including Private Banks, accounting and law firms and even Investment Consultants. What began as a simple solution to provide tailored advice has now become a complex and competitive industry with many practice management considerations, not to mention Fiduciary concerns.

In addition to external and very sophisticated competition, many Investment Counsellors and multi-Family Offices have become victims of their own success. Investment models, procedures and philosophies were designed for small, nimble client or asset bases. As account balances have grown and as clientele has expanded, approaches have had to adapt. Scalability is a vital consideration, not only for practical purposes, but to meet important investment management considerations. The pandemic certainly amplified liquidity concerns and placed many firms in difficult straits, albeit for a short period, but many of these lessons could have been learned in the Credit Crisis. Is it time to take note, or should we wait for a third time lucky before adapting?

Independence – the Independent Investment Counsellor and multi-Family Office Brand

A recent Financial Times article pointed out that independent investment advice is an antiquated argument in an era where Open Architecture provides the means for all investment providers to offer best-in-class solutions to High Net Worth investors[1]. Firms no longer have to recruit talent to provide specialist exposures; they can easily access complementary mandates to diversify client assets. This is a very important consideration in a low interest rate environment when asset models have branched into Alternative assets where scalability, liquidity and specialist knowledge are vital considerations.

According to Northern Trust, the key question for Investment Counsellors and multi-Family Offices must answer is whether they are delivering the right services as effectively and efficiently as possible to clients[2].

Our industry has spoken about the demographic imperative to manage generational wealth and for firms to provide wealth management, not just investment management to HNW clients. But firms which started many years ago must also adapt to serve a clientele because the mean age of the average HNW investor has dropped significantly. Data abounds which shows that younger investors and female investors want to allocate Capital responsibly, aware of the influence they can make through their investments [3].

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It is not surprising that many sophisticated firms like SEI, Frank Russell and Northern Trust have specialty units which provide comprehensive Family Office services to High Net Worth individuals and their families. Financial planning services like tax and Estate planning, ensuring a seamless and comprehensive approach to stewarding Capital are combined with access to world class asset managers. Similar services are also available through Canada's bank-owned brokerages, all of which combine Open Architecture investment platforms with experts in financial, tax, insurance and Estate planning.

The Role of Exchange Traded Funds

Exchange Traded Funds have blossomed concurrently with Separately Managed Accounts and Pooled Accounts at large brokerage houses, principally because they eschew the costly necessity to monitor manager performance and because Canadian-listed ETFs alleviate concerns about US Estate Taxes and T-1135 monitoring and reporting. SPIVA (S&P Index versus Active [4]), data has documented that Alpha is elusive and temporary, prompting many investment counsellors to concentrate on asset allocation, making sure assets mixes reflect objectives and risk tolerances. ETFs are more tax effective than Pools and, when compared to Separately managed accounts, can provide currency hedging, an important consideration for Canadian investors.

Many Investment Counselling firms are have built solid reputations in managing Canadian and US equities but lack the expertise in International or Emerging Market equities. Given two alternatives, accessing expensive Pools or foregoing exposure in these important asset classes, Exchange Traded Funds provide low cost, liquid and tax effective access to ensure clients are properly diversified.

It is not surprising that ETFs deserve the highest consideration in managing Fixed Income. The basic issue for most firms is that it is infuriatingly costly and time consuming to manage individual bond portfolios as a firm grows. Bond portfolios at large Investment Counsels or Family Offices become unnecessarily diverse because it is very difficult to maintain concentrated, uniform allocations across segregated accounts due to bond scarcity. As fixed income assets grow, they become unwieldy and pose administrative burdens. ETFs provide the flexibility to adapt bond allocations to changing conditions and a model scalability across a clientele, ensuring no client is left behind.

Quite simply, the ETF mechanism provides liquidity and scalability relief for Investment Counsels and Family Offices. In addition, the three levels of liquidity in an ETF help to tighten the spread cost of trading bonds, either individually or through Pools. As the table below indicates, ETF spreads are generally tighter at many points across the Yield Curve.

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Why Fixed Income ETFs

Fixed Income ETFs provide tighter execution than individual bonds

ETF Name	Ticker	Term	Credit	Underlying Institutional Spread	ETF Spread
BMO Aggregate Bond Index ETF	ZAG	Aggregate	Aggregate	0.35%	**0.06%**
BMO Short Federal Bond Index ETF	ZFS	Short	Federal	0.06%	0.07%
BMO Mid Federal Bond Index ETF	ZFM	Mid	Federal	0.09%	**0.06%**
BMO Long Federal Bond Index ETF	ZFL	Long	Federal	0.11%	**0.10%**
BMO Short Provincial Bond Index ETF	ZPS	Short	Provincial	0.06%	0.07%
BMO Mid Provincial Bond Index ETF	ZMP	Mid	Provincial	0.10%	**0.06%**
BMO Long Provincial Bond Index ETF	ZPL	Long	Provincial	0.20%	**0.17%**
BMO Short Corporate Bond Index ETF	ZCS	Short	Corporate	0.20%	**0.07%**
BMO Mid Corporate Bond Index ETF	ZCM	Mid	Corporate	0.48%	**0.06%**
BMO Long Corporate Bond Index ETF	ZLC	Long	Corporate	0.69%	**0.25%**
BMO BBB Corporate Bond Index ETF	ZBBB	Short/Mid	Corporate	0.31%	**0.26%**
BMO High Quality Corp.Bond Index ETF	ZQB	Short/Mid	Corporate	0.20%	**0.16%**

Source: BMO GAM

BMO Global Asset Management 18

In a low interest rate environment, many HNW investors have expressed interest in Alternative assets, though they may underestimate the liquidity constraints common to these exposures. Although Alternative investing in Private Equity or Debt is not suitable for open-ended ETFs, some Alternative assets may be easily accessed. Publicly-traded REITs are more liquid than physical Real Estate and Public Infrastructure is accessible at much lower thresholds, making it possible to recreate pension-style portfolios but with significantly more liquidity than would be the case in physical exposures. For those who care to remember, a large Canadian insurer was forced to place a moratorium on its physical Real Estate pool in 2008 because buildings could not be sold quickly enough to pay redeemers in the fund. Liquidity is a risk which should be measured and managed, not assumed.

Some Alternative strategies like Call and Put writing are difficult to scale across a broad clientele, but ETFs using these tax effective yield enhancing and risk management strategies may help to diversify portfolios. BMO ETFs is the world leader in Covered Call ETF strategies, managing over $6bln across Canadian, US and International equities. These rules-based strategies have distinct advantages because Covered Call option premium is taxed as Capital Gains, making foreign equities far more attractive when managing cash flow needs for wealthy clients who want to maintain their buying power.

Another vital consideration for firms catering to very HNW families is their ability to meet Responsible Investing or ESG expectations which often accompany generational wealth transfers. The Responsible Investing realm is an enormously costly endeavour for Investment Counsellors or Family Offices because they must buy information from a respectable third party and then must integrate RI or ESG considerations into their investment process. This is an onerous prospect for any firm and may pose significant questions. Furthermore, most Counselling firms or Family Offices lack the wherewithal to engage management or to Steward Capital in Proxy voting. This latter area is a crucial element because it reflects strong Governance to fulfil aspirations identified in RI / ESG security screening.

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ESG ETFs provide a transparent, low cost and rules-based methodology which establishes a strong foundation for Responsible Investing. The holdings are known, so it is possible to measure the degree to which the portfolio meets the United Nation's 17 Sustainable Development Goals. This foundation allows different parties to build consensus on how Capital can be allocated Responsibly, providing broad Index exposures to meet short, mid and long-term investment objectives.

Summary

As Counsellors and multi-Family Offices evaluate their practice management, the scope and depth of their services and the scalability of their investment models, Exchange Traded Funds can provide advantages for investors and firms alike. ETFs were conceived to be Institutional tools when they were created, but their application to managing a 21st century Investment Counsel and Family Office are equally worthy.

Less time spent reviewing holdings reports or trading can be translated into better asset allocation decisions, managing macro risks and gauging their relevance to personal short, mid and long-term wealth objectives. These determinations are perhaps the most important element in an increasingly competitive industry.

1. Investors should look beyond the label in choosing a modern multi-family office, S Foley, The Financial Times, 6 October 2020;
2. 2020 Family Office Benchmarking Report, Northern Trust, 18 November 2020;
3. Top Trends in Wealth Management 2020: What You Need to Know, CapGemini, January 2021
4. SPIVA Report, June 2020