ENVESTAT
INTERSECTION

October 2015

This quarter's Envestat Intersection continued our theme from last quarter on advisory practice growth, largely because of the questions our clients are asking us:

1. We are constantly hearing about the "robo" trend. Should we really be going downstream as a way to grow our practices?

2. If we don't want to go downstream, or if we want to try another growth strategy, should geographic expansion be on our list?

3. I'm making the shift from commission to fee business, but when will I finally achieve operating efficiencies or scale?

4. Does product selection actually play a role in our growth?

This report is designed to help you answers those questions.

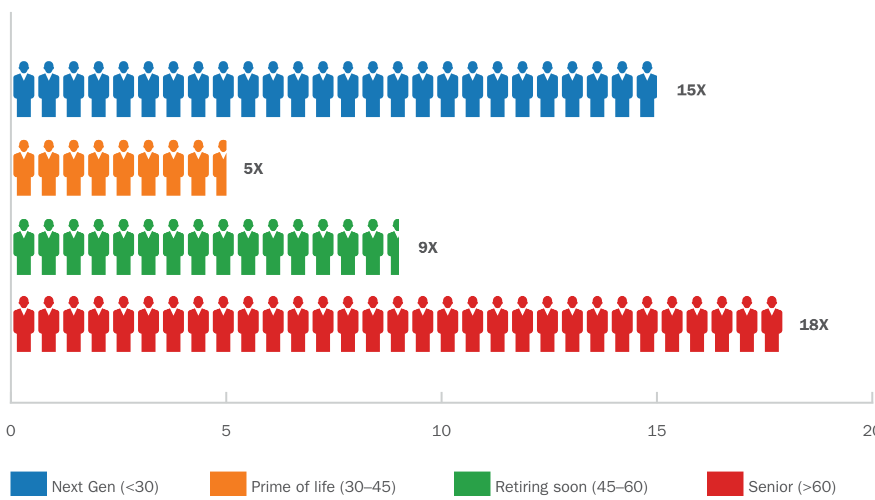
Top Growth Advisors Really are Going Downstream

The industry has long struggled with the balance between serving those clients who have greater investable assets and capturing emerging clients whose relationship with the firm can grow along with their assets. This topic is back in the driver's seat of industry focus, as digital advice providers have become a major stakeholder. We concur there's a gap in many of the industry publications: much of the digital trend seems to be focused only on "Millennial" investors. Our analysis of the top-growth advisors suggests they have been effective moving downstream through all life cycles. The chart (below) illustrates that top-growth advisors not only dominate the service of the "next gen" investor, but also are growing assets in other emerging categories by 5 and 9 times the overall peer average. It's important that firms engage the emerging segment. It also requires using technology to segment the service menus, create a good client experience, and enable self-service functionality to make it profitable to serve this client base. As firms move downstream, they have to "hold the line" and be willing to say "no" to clients who have not paid for premium service. If firms are not willing to stay committed to their service menu differences, they become vulnerable to fee compression on the top end and over-serving on the bottom end, both of which erode profitability.

Graph 1:
Millennials: Top Growth Advisors Really are Paying Attention

Top growth advisors are growing assets with next generation investors at a rate of 15 times the overall peer group.

Growth multiple of top vs peer advisors by client age demographic



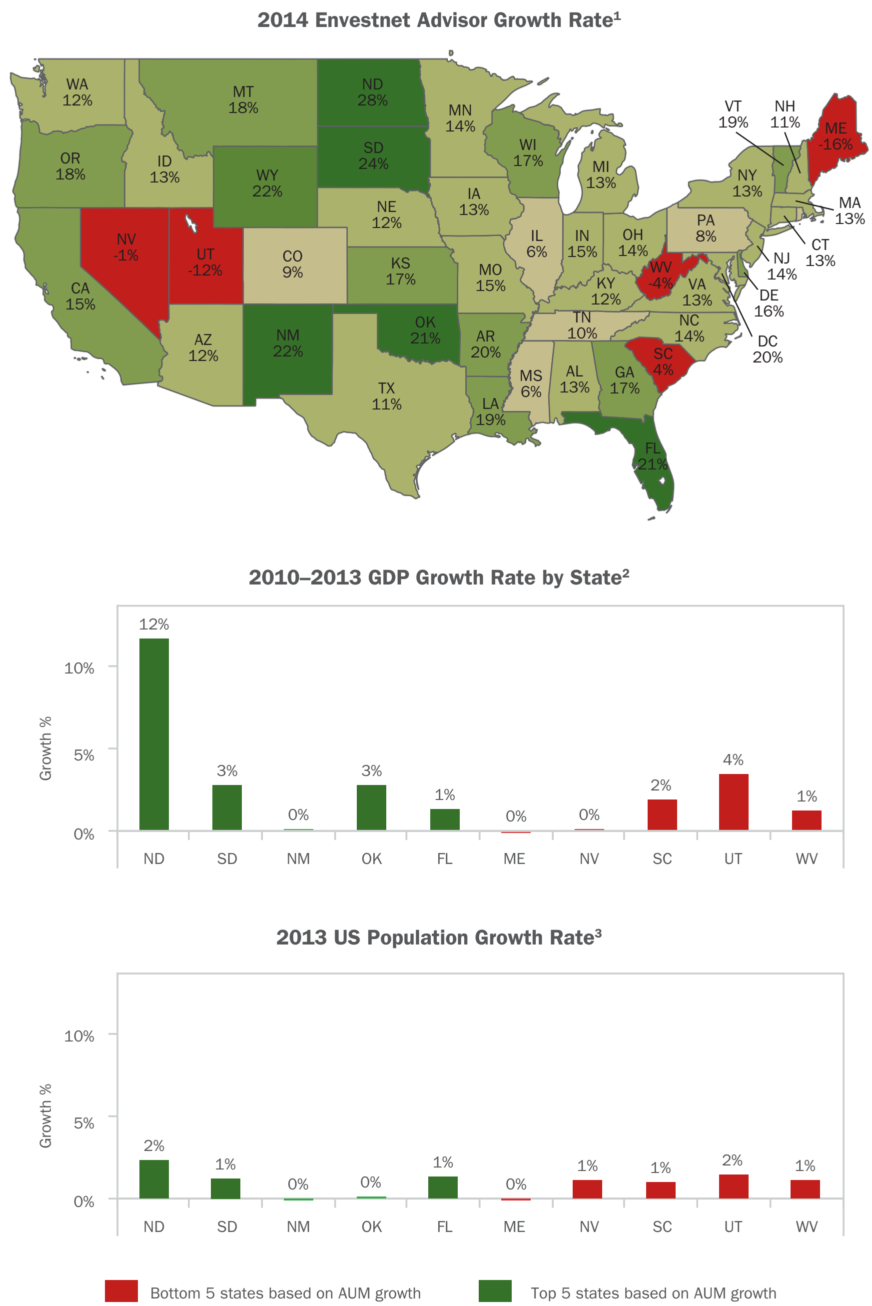
Growth multiple indicates how fast have top advisors been able to grow their AUM compared to peers in 2014
The analysis universe comprises of advisors above specified asset and account threshold limits

The Gold Rush of 2015?

On January 24, 1848, James Marshall discovered gold in Coloma, California, and the gold rush was on. By 1849, 300,000 people had relocated to California in search of riches, which led to a wave of regional tourism and economic development. Today, as firms search for areas of growth, many look to the potential of regional expansion in all channels. In the RIA channel, we observe the rise of aggregators and the continued growth of independent firms seeking to build national brands. We also see individual RIA firms building a national presence.

Graph 2:
Economic Indicators Not Enough To Forecast Asset Growth

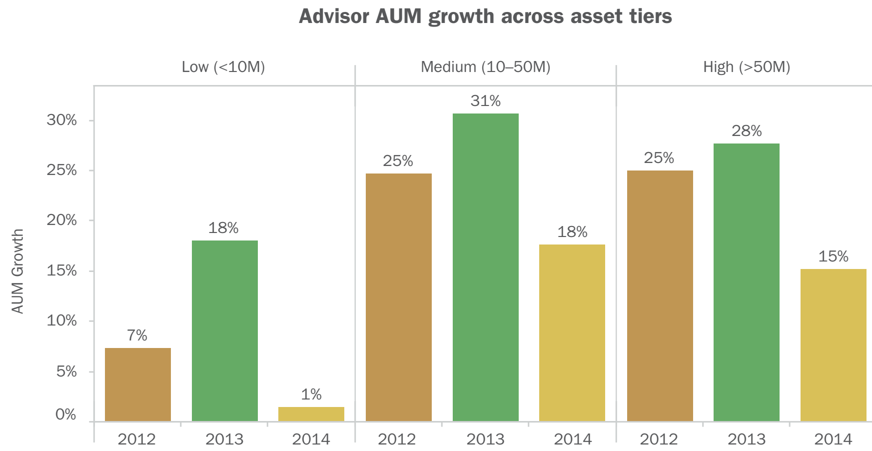
There is no silver bullet in determining where to grow. Firms must also assess their technology infrastructure, local culture, and the impact on their organizations.



Geographic expansion brings a number of business challenges: scale, culture, and technology that supports multiple locations. Our analysis this quarter also shows that picking the expansion area can be difficult. Many firms look at economic indicators to signal asset growth, but our analysis shows this isn't a silver bullet answer. Firms assessing whether they should expand geographically must consider not only the asset growth and key economic indicators, but also assess their technology infrastructure, local culture, and the impact on their organizations.

Graph 3:
$10M is The Magic Number

Achieving a critical mass in advisory AUM (~ 10 M based on our asset tiers) may be a key driver of future growth.



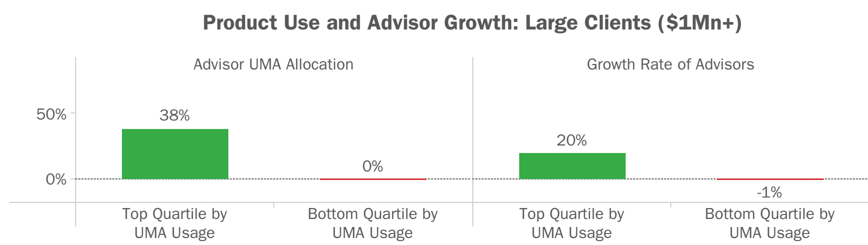
The analysis universe comprises of advisors above specified threshold limits

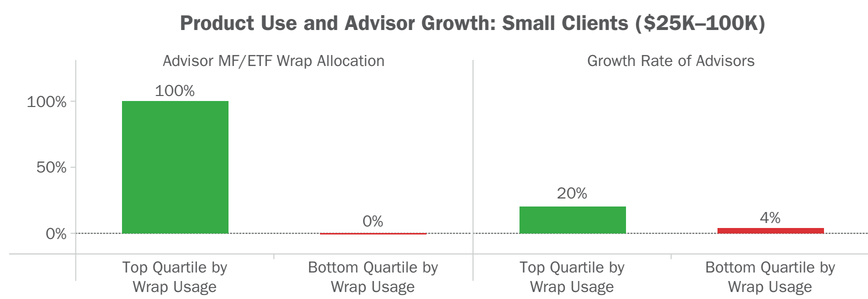
$10M is the Magic Number for Advisory

Our analysis focused on making the move from commission practices to fee business. The metrics are consistent with our practice management coaching observations: $10M in fee business is a crucial number to begin gaining scale. In 2014, advisors below $10M in fee business only grew at a 1% rate, while advisors in the two scale categories above $10M grew assets at 18% and 15%. Why is $10M key? We find that once advisors hit this level, they begin to develop processes and procedures that support scaling their business. We will focus on the scale levels of other business models in future reports.

Graph 4:
One Size Doesn't Fit All

Advisors prefer using sophisticated products like Unified Managed Accounts (UMAs) with larger clients (> $1M) and MF/ ETF Wraps with smaller clients ($25K-100K).





The analysis universe comprises of advisors above specified threshold limits

The Right Product Solution Really Does Matter

As firms move downstream, they will need to identify the right product solutions based on the complexity of the client. This seems obvious; but when we look at the overall population of advisors, many stick to the same product solution regardless of client size, which ultimately stunts their firms' growth. Graph 4 shows that using packaged solutions for smaller clients and more sophisticated UMA structures for larger clients actually drives growth. Using the UMA structure for larger accounts is especially important, because it allows firms to bring more sophisticated/value-added tax overlay management to clients, a vital differentiating strategy compared to digital advice providers. The UMA structure also allows the advisor to change managers without re-papering. Given recent market volatility, having the ability to change strategies quickly not only makes the advisor more proactive, but also makes for a better client experience.

Next Quarter:

Advisors provide value to their end clients in a variety of key areas. We will assess these "pillars of value" in next quarter's Envestats.

About Envestnet

For more information on Envestnet, please visit www.envestnet.com and follow @ENVintel.

Envestnet, Inc. (NYSE: ENV) is a leading provider of unified wealth management technology and services to investment advisors. Our open architecture platforms unify and fortify the wealth management process, delivering unparalleled flexibility, accuracy, performance, and value. Envestnet solutions enable the transformation of wealth management into a transparent, independent, objective, and fully aligned standard of care, and empower advisors to deliver better outcomes.

Envestnet Institute is your portal to timely and thought provoking content in partnership with finance's top thought leaders. Register to learn more about the markets, to discover new investment tools, and to assess new ways to serve your clients' needs. If you are a registered investment professional, you can take courses for continuing education credit as well as read documents and watch videos on the Envestnet Institute platform.

Sources:

[1] Envestnet Platform

[2] BEA official website. News Release: GDP by State

[3] "Annual Estimates of the Resident Population for the United States, Regions, States, and Puerto Rico: April 1, 2010 to July 1, 2014". 2014 Population Estimates. United States Census Bureau, Population Division. December 23, 2014. Retrieved December 23, 2014.

EN-ENVINT-1015