
TRENDS IN INVESTING: PAST,
PRESENT, AND ANTICIPATED USE OF
VARIOUS INVESTMENT VEHICLES
AMONG PROFESSIONAL FINANCIAL
ADVISERS

*WHITE PAPER DEVELOPED BY THE
FPA RESEARCH CENTER*

JUNE, 2011

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INTRODUCTION

Investment planning is a core component of financial advice and financial planning. While the market crash in 2008 heightened consumer awareness of the complexities and risks of investment planning, many advisers already had a sophisticated approach and calculated investment strategy. Even as the economy improves, advisers continue to keep a watchful eye on asset allocation.

Outsourcing continues to gain popularity, at least with the advisers who currently outsource and plan to increase their future use. Advisers continue to adopt exchange-traded funds (ETFs), though mutual funds still significantly outweigh ETFs when it comes to the amount of assets allocated. The passive vs. active debate continues and although advisers' economic outlook is generally bullish, inflation expectations are growing.

This white paper can help you better understand the current investment planning landscape along with the most common strategies, tactics, and products used by advisers to help their clients achieve their goals. As an adviser you can compare your practice to your peers, see what other products or techniques are being used by advisers, and see what your fellow advisers expect in the next few years.

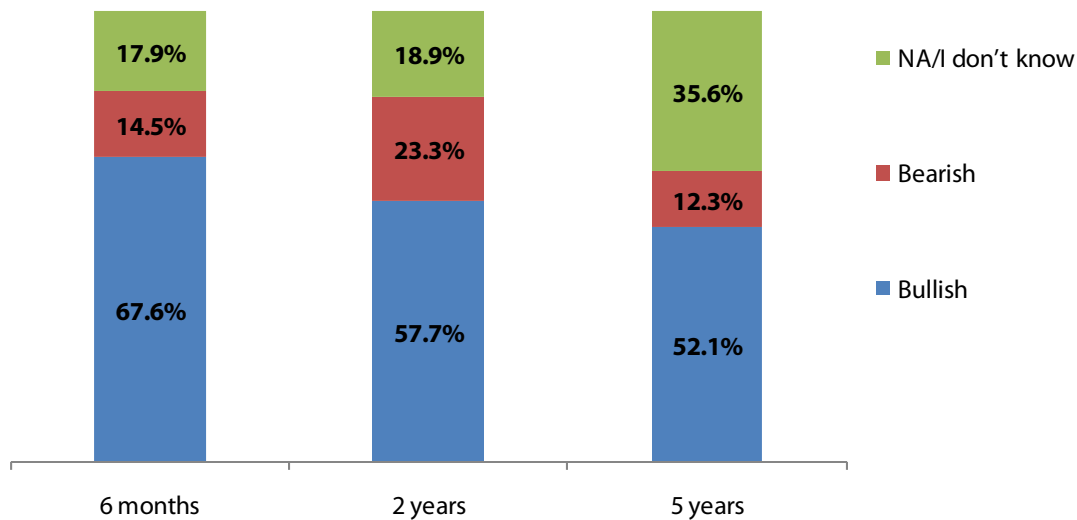
LANDSCAPE

While the majority of survey respondents implement or manage investments for clients on an ongoing basis, a significant percent outsource a portion of their clients' assets and plan to increase the amount they outsource in the future. Outlook remains positive for the next 5 years and economic change continues to prompt adjustments in asset allocation strategy.

ECONOMIC OUTLOOK

In the short term advisers are overwhelmingly bullish, though that cools down when it comes to the 2-year outlook. While a significant percentage of advisers feel uncertain when it comes to a 5-year outlook, overall it still looks positive with more than half of advisers maintaining their optimism. See Exhibit 1.

Exhibit 1: What is your economic outlook over the next...



SERVICE MODEL

It is most common for a practice/adviser to manage investments on either a discretionary or non-discretionary basis. Few advisers report that their practice offers investment advice/recommendations but does not implement those solutions on behalf of the client.

OPTIONS	PERCENT
I/my practice offers investment advice/recommendations but does not implement.	11.8%
I/my practice implements investment recommendations on a non-discretionary basis.	44.0%
I/my practice manages ongoing investments on a discretionary basis.	52.3%
None of the above	6.6%

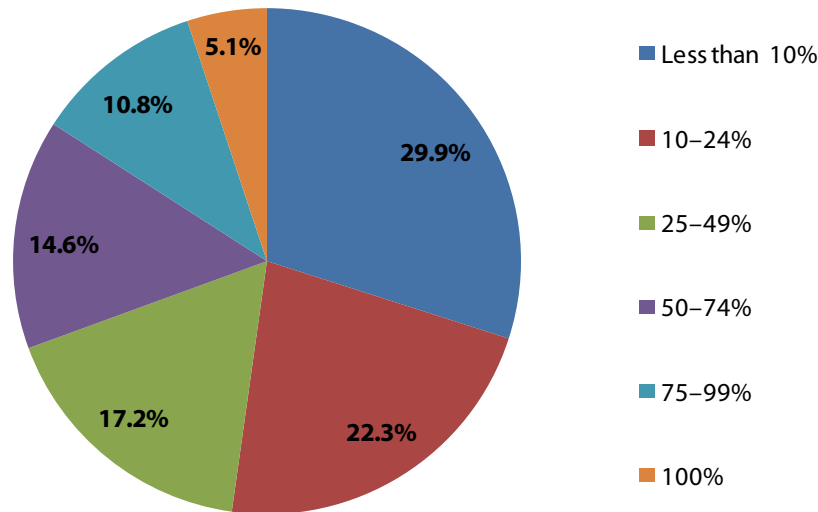
Note: Respondents were allowed to select more than one answer, except for "none of the above".

OUTSOURCING

Nearly half of advisers use some form of investment management outsourcing. Separately managed accounts (SMAs) are most popular with nearly one-third of advisers reporting use of SMAs. About one-quarter report using turnkey asset management platforms (TAMPs), and 57 percent say they do not outsource investment management for any of their clients.

Although the use of outsourcing is widespread, those who do outsource typically outsource less than half of their clients' assets. It is possible that advisers are only outsourcing specific types of more complex investment products.

Exhibit 2: Percent of Client Assets Outsourced

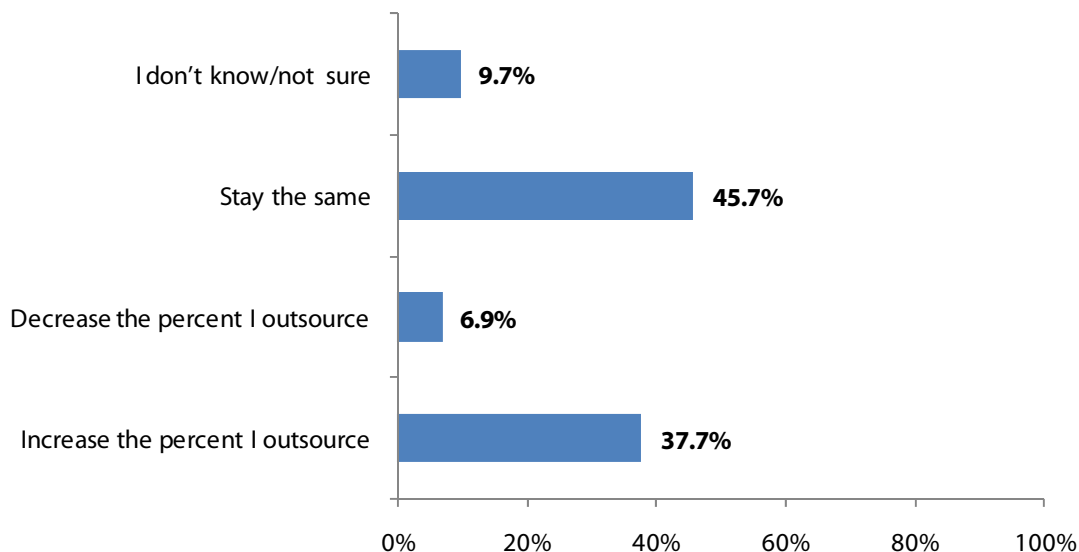


Outsourcing is a continuing trend as seen in the change in outsourcing that advisers report over the past 10 years. One-third of advisers are outsourcing more than they were a year ago, and nearly half are outsourcing more than they were 10 years ago. As the number of investment products continues to increase in volume and complexity, this growth in outsourcing is likely to continue—at least for those more niche products—as advisers seek ways to spend more time with clients and less time handling back-office functions.

Change in Outsourcing			
	12 months ago (February 2010)	3 years ago (February 2008)	10 years ago (February 2001)
More	37.7%	42.3%	46.9%
Less	14.3%	18.9%	17.1%
Same	46.3%	34.3%	21.1%
I Don't Know/NA	1.7%	4.6%	14.9%

About one-third of advisers report that they intend to increase the percent of assets they outsource with only 7 percent indicating intent to decrease the amount they outsource.

Exhibit 3: Over the next 12 months, do you intend to take any of the following actions?



CHANGES IN ASSET ALLOCATION

More than half of advisers report that they have re-evaluated their asset allocation strategy in the past 3 months. In fact, only one-third (38.2 percent) of advisers said they did not recently and are not currently re-evaluating the asset allocations strategy they typically recommend/implement.

Why did you/are you re-evaluating the asset allocation strategy you typically recommend/implement?	
Legislative/Tax Changes	
Anticipated/existing changes in income tax legislation	37.7%
Anticipated/existing changes in investment tax (capital gains, interest, etc.) legislation	33.3%
Anticipated/existing changes in estate tax legislation	16.9%
Anticipated/existing changes in health care law	13.9%
Other anticipated/existing changes in legislation (please specify topic area(s))	3.0%
Economic/Investment Changes	
Anticipated/existing changes in the economy in general	69.3%
Anticipated/existing changes in inflation	58.4%
Anticipated/existing changes in specific investments	57.6%
Anticipated/existing changes in administrative aspects of investments (cost, lead manager, etc.)	14.3%
Ongoing/Other	
I am continually re-evaluating the asset allocation strategy I typically recommend/implement	84.0%
Other (please specify)	3.9%

There are myriad reasons for this re-evaluation. Advisers who currently or recently re-evaluated their asset allocation strategy most commonly report that they continually re-evaluate. One of the current hot topics is inflation and advisers are already responding.

More than half of those who recently/currently are re-evaluating their strategy noted that inflation is one of the prompts for their re-evaluation. Those who indicated a change stemming from inflation concerns were asked to indicate inflation-protection strategies/actions they typically take. The most popular inflation allocation strategy is increasing allocation to equities (68 percent of respondents selected) and decreasing allocation to bonds (61.5 percent of respondents selected).

The overriding theme is that advisers are continually re-evaluating their asset allocation strategy and are taking into account investment performance and economic, legislative, tax and other changes to make effective decisions on behalf of their clients.

SCREENS

A wide range of screens are available for evaluating mutual funds and ETFs. Advisers were asked to select up to 5 of the top screens they use when evaluating specific funds. While there are dozens of available screens, only expense ratio stands out from the crowd.

For mutual funds and/or ETFs, please select up to 5 of the top criteria or screens to you use to evaluate/select the specific funds.	
Expense ratio	64.5%
Long-term relative performance (5 years, 10 years)	50.4%
Volatility measures (e.g., beta, standard deviation)	43.7%
Risk-adjusted performance	42.9%
Style consistency within portfolios	32.8%
Peer-group ranking (e.g., Lipper, Morningstar)	31.7%
Lead manager tenure	30.1%
Alpha	24.5%
Medium-term relative performance (3 years)	19.2%
Diversification (# of positions held)	17.9%
Comparison to investable benchmarks (e.g., ETFs)	17.1%
Up-down market capture	17.1%
Absolute performance	11.7%
Star ratings	10.9%
Short-term relative performance (YTD, 1 year)	9.3%
Overlap of securities	9.1%
Tracking error relative to benchmarks	8.8%
Other (please specify)	6.1%
Total assets	5.9%
R squared	5.3%
Monthly returns	2.4%
Manager communications (e.g., quarterly letters)	2.1%
Peer recommendation	2.1%
Information ratio	1.3%
None	0.5%

INVESTMENT USE

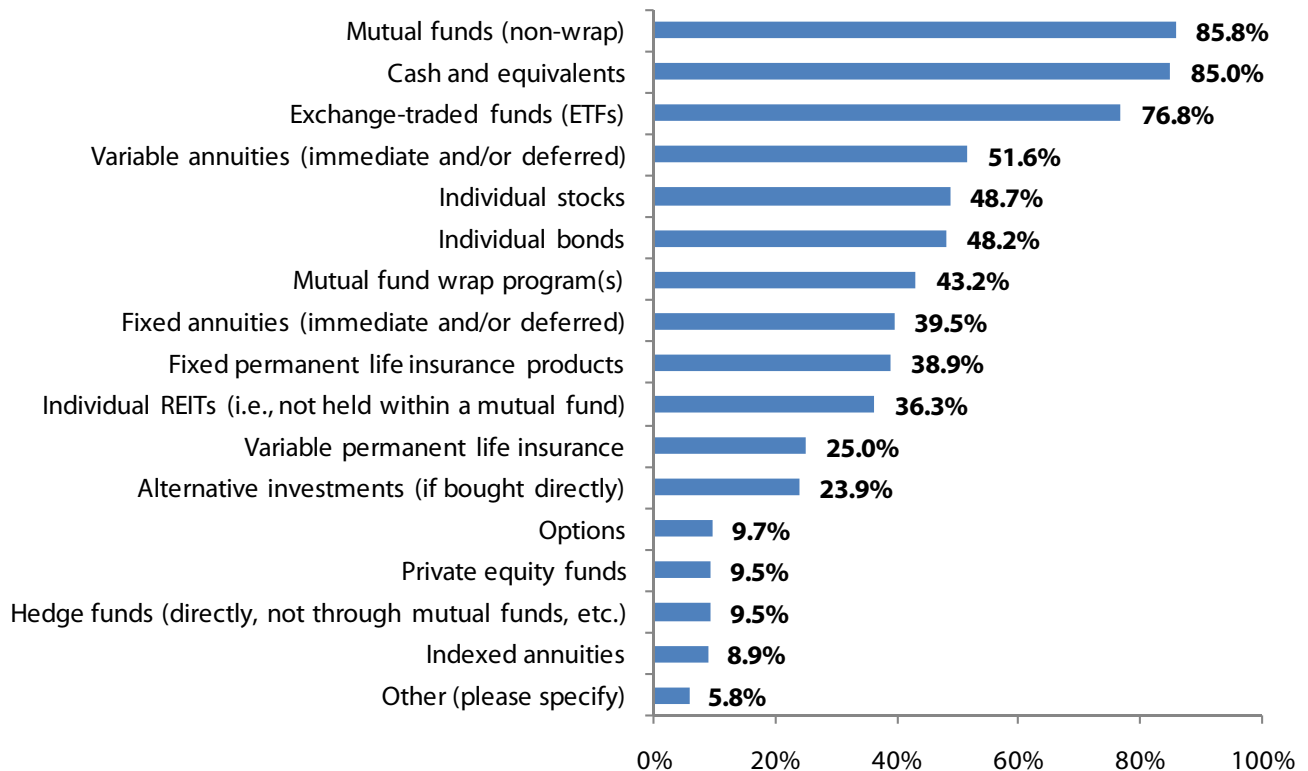
Completely new types of investment vehicles are launched regularly and the number of specific products available in any given category constantly changes. Additionally, debates over active vs. passive management and alternative investments compound the work advisers have laid out for them.

PRODUCTS/VEHICLES USED

Mutual funds are king, but ETF use among advisers continues to gain momentum. A large percent of advisers continue to use cash and equivalents—a sign that advisers are still continuing the strategy adopted post-crash and it remains to be seen if this trend will become standard.

Advisers were also asked to indicate if they use target date or target risk funds. One-quarter of advisers use each type of fund with 28 percent using/recommending target date funds and 25.5 percent using/recommending target risk funds.

Exhibit 4: Please select all the investment vehicles you currently use/recommend with your clients:



While ETFs are gaining popularity in terms of the percentage of advisers who are currently using/recommending them, they do not come close to gathering the amount of assets that advisers allocate to mutual funds. In fact, mutual funds account for just over half of assets—nearly five times the amount allocated to ETFs.

Percent of assets under management or supervision in	2011
Mutual funds (non-wrap)	34.9%
Mutual fund wrap program(s)	16.2%
Exchange-traded funds	10.8%
Individual stocks	8.8%
Cash and equivalents	7.0%
Variable annuities	6.6%
Individual bonds	5.7%
REITs	1.8%
Fixed permanent life insurance products	1.6%
Fixed annuities	1.5%
Alternative investments	1.3%
Variable permanent life insurance	1.2%
Other	1.1%
Indexed annuities	0.6%
Options	0.4%
Hedge funds	0.3%
Private equity funds	0.3%

EXCHANGE-TRADED FUNDS VS. MUTUAL FUNDS

With the rise of actively managed ETFs, one key question is when to use an ETF and when to use a mutual fund. Advisers who use/recommend both types of products were asked what prompts them to use one type over another. They most commonly indicated that they don't really compare ETFs to mutual funds, but rather they compare the specific investments available to their clients and simply chose the investment that best fits their clients' needs.

OPTIONS	PERCENT
I don't choose one vehicle over another – I evaluate specific investments from both categories and simply chose the product that best fits my clients' needs.	66.3%
I use the most tax efficient vehicle that suits my clients' needs.	36.6%
I use the least expensive vehicle that suits my clients' needs.	31.9%
I usually recommend specific products from both vehicle classes.	30.8%
I use ETFs with one type of client, and mutual funds with a different type of client.	14.7%
It is based on client request.	8.2%
Other (please specify)	4.3%

Those who use mutual funds but not ETFs most commonly say it is because they prefer the management style available in mutual funds. One-third say that they use mutual funds over ETFs because mutual funds are easier for their clients to understand. At present, few advisers use ETFs but not mutual funds so statistically valid insights are not available for that group.

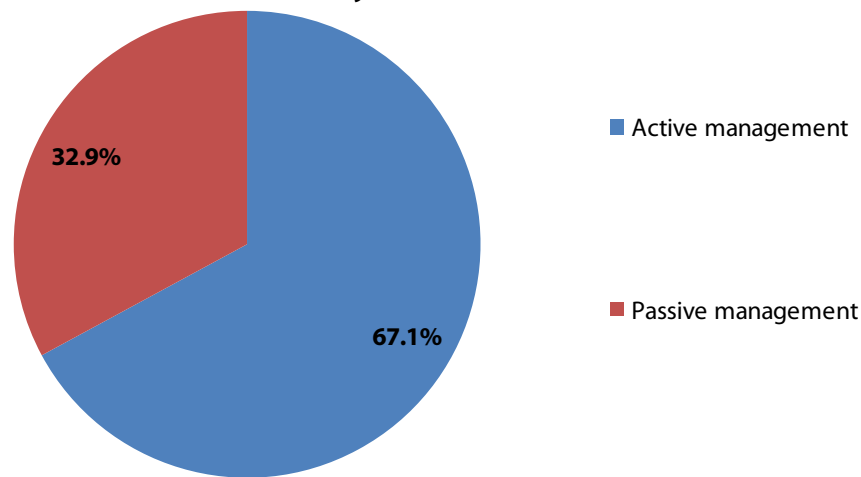
ACTIVE VS. PASSIVE

The differences in preferred management styles are also shown in the percent of assets advisers place in active versus passive funds. Of those who use mutual funds, an average of 70 percent of allocated

mutual fund assets are placed in active funds with the remainder in passive funds. With ETFs, only 24 percent of allocated ETF assets are in active funds.

When it comes to overall performance, advisers generally believe that active management provides the best overall investment performance, even when taking cost into account.

Exhibit 5: In general, which type of management do you think provides the best overall investment performance taking into account costs associated with each management style?

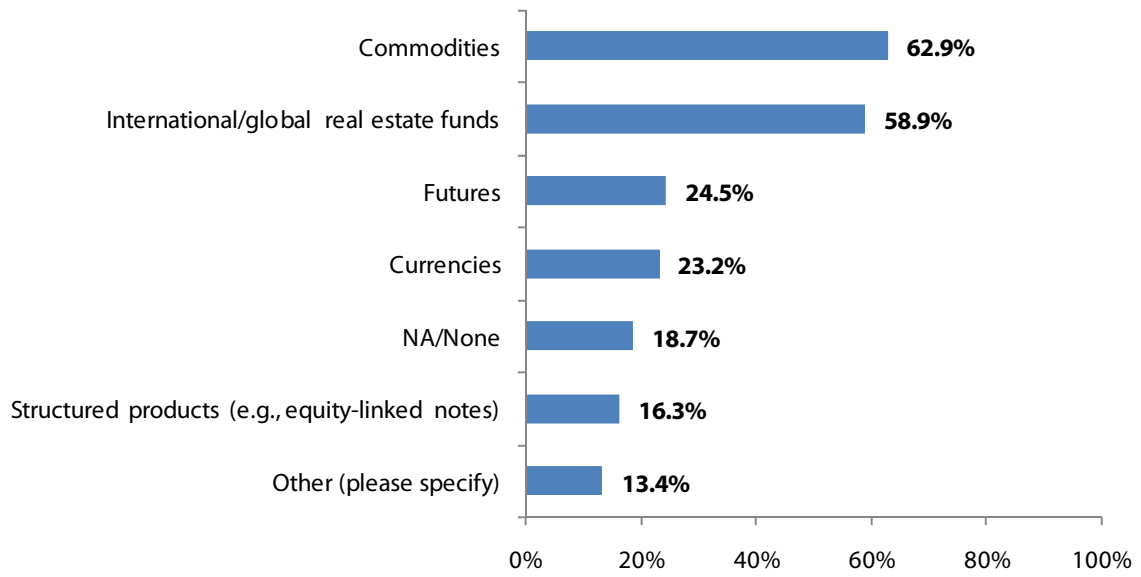


ALTERNATIVE INVESTMENTS

About one-quarter of advisers indicated that they use/recommend alternative investments (directly bought—not included in other investment vehicles). When alternatives within a mutual fund or ETF are included, that number increases to 81 percent of advisers.

Commodities and international/global real estate funds are the most commonly used/recommended alternative investments. The most common “other” alternatives (not included in the exhibit below) include long/short funds, hedge funds, real estate, and oil/gas.

Exhibit 6: Percent of Advisers Who Use/Recommend Alternative Investments



FUTURE TRENDS

While no one knows the future, most advisers have a sense for anticipated changes in their allocation strategy in the next 12 months. Advisers also anticipate a fairly high rate for average annual inflation over the next 5 years.

ANTICIPATED USE

Mutual fund wraps, alternative investments, and ETFs stand the most to gain over the next 12 months. Overall, advisers expect their use of non-wrap mutual funds, individual bonds, and cash and equivalents to decrease. In addition, 25 percent of advisers intend to use more actively managed funds while 16 percent plan to use more passive funds.

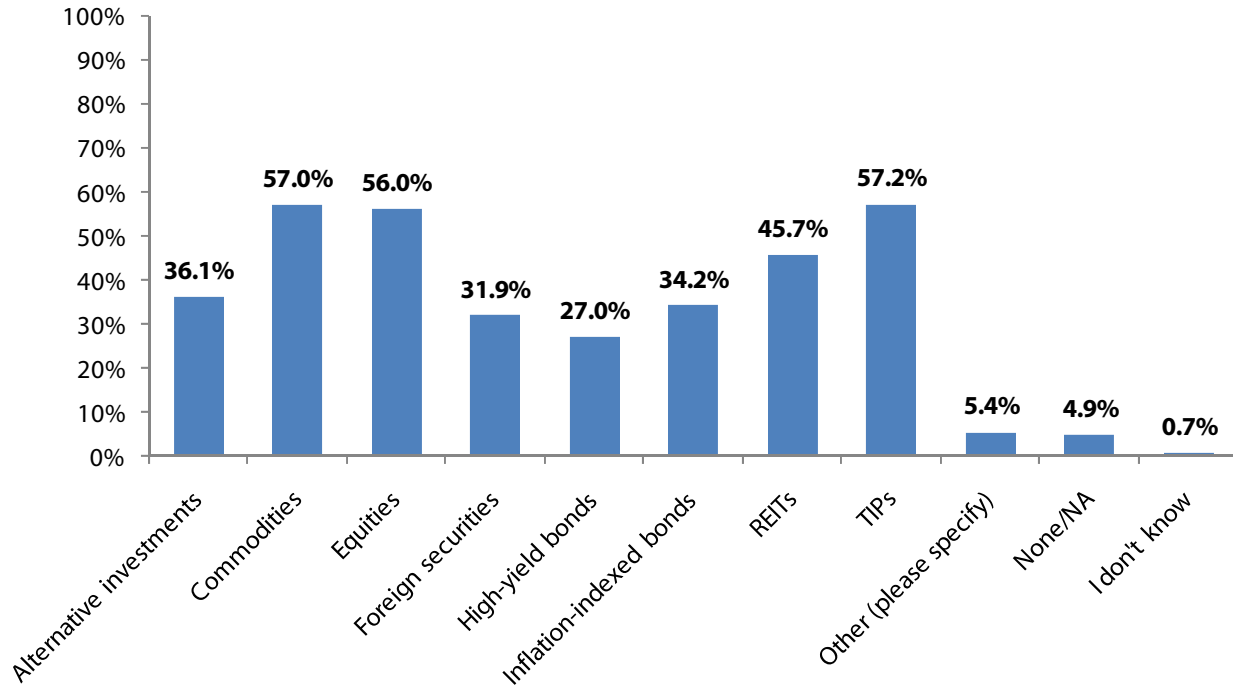
Anticipated Change in Use Over Next 12 Months			
	Increase	Decrease	Stay the same
Mutual fund wrap programs	54.3%	4.9%	40.9%
Alternative investments	48.4%	3.3%	48.4%
Exchange-traded funds (ETFs)	36.6%	4.8%	58.6%
Individual REITs	36.2%	6.5%	57.2%
Hedge funds	33.3%	5.6%	61.1%
Individual stocks	31.4%	10.8%	57.8%
Variable annuities	28.6%	6.6%	64.8%
Fixed permanent life insurance	26.4%	6.8%	66.9%
Private equity	25.0%	8.3%	66.7%
Indexed annuities	20.6%	8.8%	70.6%
Mutual funds (non-wrap)	19.3%	24.8%	55.8%
Variable permanent life insurance	18.9%	8.4%	72.6%
Options	18.9%	2.7%	78.4%
Fixed annuities	15.3%	14.0%	70.7%
Individual bonds	14.2%	27.3%	58.5%
Cash and equivalents	9.3%	24.8%	65.9%

INFLATION

There are definite expectations of an increase in inflation over the next 5 years. On average, advisers expect to see 2.6 percent in annual inflation over next 12 months, 3.45 percent in the next 2 years, and 4.24 percent in the next 5 years.

With expectations this high, future use of commodities, equities, and TIPs among advisers will likely increase. Many advisers also report using alternative investments, foreign securities, inflation-indexed bonds, and REITs as investment vehicles they typically use as inflation hedges.

Exhibit 7: Which of the following, if any, do you typically use as inflation hedges?



TRENDS OVER TIME

Since 2006 advisers have reported their investment vehicle use. While some of the answer choices have been adjusted over time (and therefore are not reflected in the table below), the data clearly shows some trends over time, particularly as advisers adjusted to the market crash in 2008 (note that the 2008 survey was fielded in February of 2008 and should be viewed as part of the pre-crash strategy).

The biggest trends over time include an increase in the percent of advisers using cash and equivalents and ETFs, and a decrease in the use of individual stocks.

Investment Vehicles	2006	2008	2009	2010	2011
Cash and equivalents	52.7%	52.4%	84.6%	84.0%	85.0%
Exchange-traded funds	40.1%	44.4%	72.3%	72.4%	76.8%
Individual stocks	66.4%	69.2%	45.7%	49.1%	48.7%
Fixed annuities	35.9%	22.8%	44.6%	49.1%	39.5%
Permanent life insurance products (i.e., UL, VUL)	32.8%	29.2%	45.1%	51.2%	42.6%
Individual bonds	60.0%	52.8%	50.6%	52.0%	48.2%
Hedge funds	8.6%	5.2%	5.7%	13.0%	9.5%
Variable annuities	58.2%	58.4%	54.3%	53.4%	51.6%
Private equity funds	3.2%	2.8%	6.9%	8.1%	9.5%
Mutual funds (non-wrap)	84.7%	81.2%	86.3%	88.3%	85.8%
Mutual fund wrap program(s)	39.1%	44.0%	45.1%	42.3%	43.2%
Other	4.5%	7.6%	4.9%	4.6%	5.8%

Note: the vehicles are sorted from largest to smallest standard deviation. 2007 data is not available.

Over the past year, the use of various investment vehicles has not significantly changed. Mutual funds still dominate and the top 5 investment vehicles make up approximately three-fourths of adviser allocations.

Percent of assets under management or supervision in:	2010	2011
Mutual funds (non-wrap)	32.2%	34.9%
Mutual fund wrap program(s)	14.3%	16.2%
Exchange-traded funds	10.7%	10.8%
Individual stocks	8.2%	8.8%
Cash and equivalents	7.4%	7.0%

APPENDICES

For more information on how this research was conducted and the size and type of advisory firm represented, please refer to each applicable section.

METHODOLOGY

This report was derived from an online survey of 407 complete responses from financial advisers who provide financial planning to clients and are members of the Financial Planning Association (FPA). The survey was fielded in February 2011 and has a 5 percent margin of error.

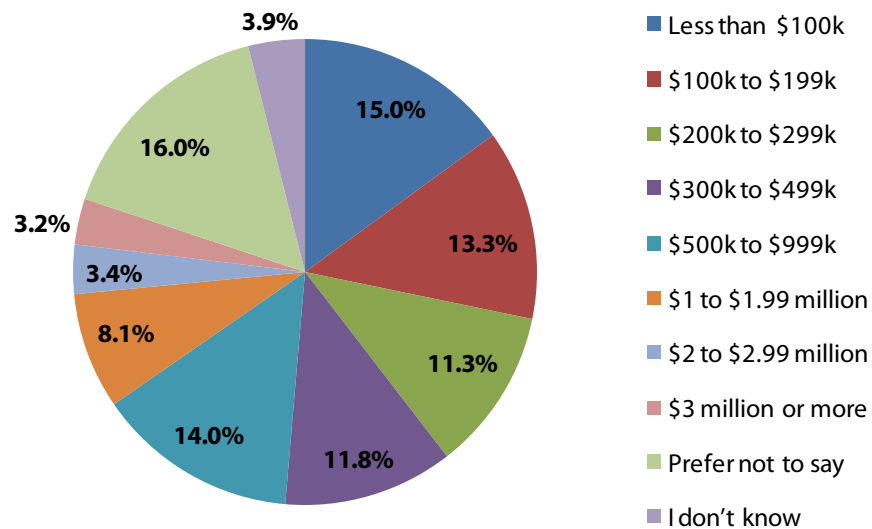
RESPONDENT PROFILE

On average, respondents have been working for 17 years in financial services. One-third are advisers in a single-adviser practice, one-third function as the CEO, owner, or managing partner for their practice/firm, and one in seven are a senior or junior financial planner within their practice/firm.

Respondents are also largely representative of smaller firms with one-third at a firm with only a single adviser operating the entire practice. Nearly 40 percent work in a firm with 2 to 5 full-time employees (including the respondent and any working owners/partners). One in five work at a practice/firm with 6 to 15 full-time employees/advisers/partners with the remainder working at firms with 16 or more employees.

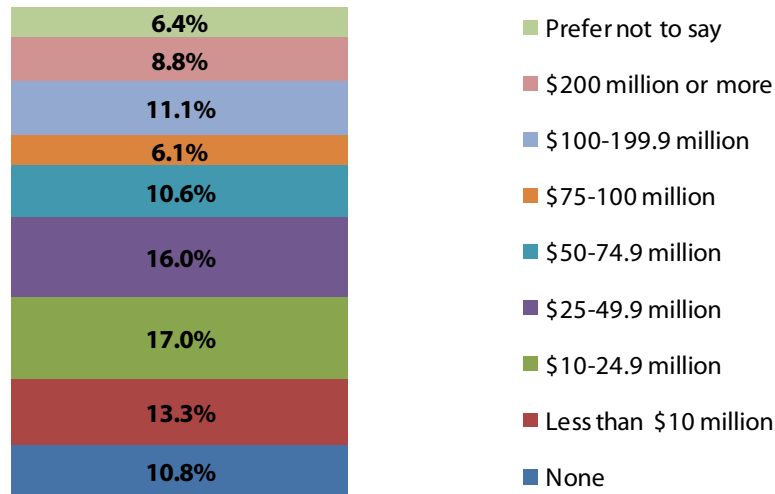
In terms of revenue, the size of firms represented is varied with respondents representing practices with less than \$100k in annual revenue to practices with more than \$3 million in annual revenue.

Exhibit 8: Practice's Annual Revenue



Assets under management/discretion also vary dramatically from advisers who don't directly manage assets to those with \$200 million or more under the respondents' **personal** management/discretion.

Exhibit 9: Assets Under Management/Discretion



Most respondents operate in an RIA or dually-registered environment with one in six operating as independent advisers affiliated with a broker-dealer (no IAR registration).

OPTIONS	PERCENT
Registered representative working as an employee for a broker-dealer	4.2%
Registered representative working as an independent adviser affiliated with a broker-dealer	16.2%
Registered representative working for a bank, credit union or savings & loan	2.2%
Dually registered adviser (registered with FINRA as a registered rep along with IAR registration with the state or SEC)	26.5%
Independent IAR/RIA	38.6%
Unregistered planner/adviser	6.9%
Other (please specify)	5.4%

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