The Changes Go Retail

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The changes that started with family offices are going retail and changing the investment process with smaller investors with limited resources. In a recent e-mail, I received word of the coming crisis in the financial industry. It was from the U.S. "Given the crazy economic times in which we live, the financial industry is about to change forever. In as little as one year, many will be out of the business for good – not because they want to be out of the business, but because they will be forced out." Of course, it was a marketing e-mail designed to buy videos or whatever to help sell to the smaller investor. However, it is a very strong sign that the same demands of ultra high net worth indivduals and family offices are now reaching the general public. All should take heed.

Family offices and wealthy individuals have been on a straight line to radically change how their assets are managed and invested and the returns reported for the past several years. It continues with increasing steam and focus. An entire industry is developing to support their unique needs for accurate, transparent information. Family offices are working to do club deals, realizing they are often the "subject matter expert" for many deals, and the only thing a fund or a bank brings is additional cost and lower returns. Those large bonuses in the newspapers are made somewhere, right?

Whose money is at risk? The person with the greatest risk should get the return. What happens when things go wrong in a deal? If things go wrong, the proper manager fixes the deal himself. Most of the assets raised should go into the deal and not be lost in organization and distribution. What's more, who came up with the idea of 2 and 20? To the uninitiated, a fund may charge 2% per year plus 20% of the gain on exit. It is accepted just as blindly as your charge to use the ATM. Did they really earn that fee? Was it in any way related to the actual cost they incurred? Family offices have answered with a resounding "no!" upon investigation. They can often simply do better themselves.

Yes, reasonable sensibility is creeping into the financial world. Costs are being eliminated, fees are being significantly reduced. The middleman is no longer needed. Look at the automotive industry and the tremendous change they made in the 90s. It went through the entire manufacturing and service industries. Do you think the financial world is somehow exempt from such change?

One of the best cases is the UBS story. They have gone through tumultuous times and now, per a Reuters report, will focus on private banking. The bank is focusing on its most profitable business unit. Smart move, but it could very well be a sand hill they are looking at, not the Matterhorn. There are major layoffs announced by the bank to re-focus this great institution. However, if they do not change how they offer their services and move toward the new model of investing which family offices and private investors demand, the sand hill will blow away. They will move to a market that is no longer there. All banks, asset managers, fund originators, intermediaries and the supply chain of financial products must take note and take heed.

If a private deal makes 5% more a year than your favorite fund product, which will you chose? Yes, structures cost money and reduce returns. Some say it is required to protect the investor. There was no protection from these structures in 2008. Will there be any in 2014? Past results are not an indication of future performance. However, it is highly unlikely to have a different result.

Fees on assets under management are dropping faster than a "blue light special". Now funds are managed for well under 1% per year. Flat. No added profit for indirect fees on transactions, no bonus or hurdle rates. Slowly, the discussion is changing to a serious review of the cost of fund management, not the price charged by others and a negotiation from that price down. Asset managers and special companies selling cost-cutting solutions and focused solely on the family office are leading the way in this new trend.

One other new trend that rapidly grows is the technical support for the family office. New FO conferences in the fall are more like tech events, with computer services, data and software companies realizing there has been a major shift in their customer base, or will be.

UBS and other major banks are changing how they serve the upper end of the spectrum. That is great news. However, they will soon realize that it will affect all aspects of their investment business. How they adjust will determine who will be successful in the future. Those adjustments are coming from the family office owners and private investor world. It is coming from outside the financial industry. The secrecy so revered in the financial world has kept them from an open discussion on the real trends for the future. What started with a few family offices working together in club deals flows now to the small investor who has the same expectation of low cost and good returns for his very hard-earned dollar.

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