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Rhyming Times

What an interesting year it was, with geopolitical events filling our news, artificial intelligence threatening to overtake actual intelligence, and stubborn inflation forcing interest rates to remain high. More locally, we have enjoyed the usual array of forecasters informing us that the New Zealand economy is near the bottom, and that a change in government will return us to the good ol' days. Even closer to home, the financial services industry has somewhat settled down following a decade of regulatory change, with an unprecedented level of interest from offshore players stimulated by our growing retirement savings sector.

And yet, there are many in the industry who choose to remain oblivious to our changing landscape, and hope that life will return to some form of normality involving low interest rates, strong consumer demand, buoyant investment markets and the ease of global tensions. Bold predictions that hope for the return of old times tend to originate from an industry community who prefer to charge an annual relationship fee in exchange for continued mediocrity. These forecasts of rhyming times remind us that those who ignore the mistakes of history are doomed to repeat them.

> *"...if you grant that the environment is and may continue to be very different from what it was over the last 13 years - and most of the last 40 years - it should follow that the investment strategies that worked best over those periods may not be the ones that outperform in the years ahead"*
>
> Howard Marks
> Oaktree

Whilst I'm unsure whether this attitude reflects complacency or arrogance (or both) it is interesting to reflect on an alternative outlook for the New Zealand financial services industry. This comes from someone who has nearly 40 years in the industry, across at least 3 different jurisdictions, and has endured at least 20 significant investment market corrections of more than 10% during this time.

Let's start with the outlook for economies and markets. The simple response here is that no one knows, noting six of the seven economists that we follow were advocating that interest rates would remain 'lower for longer' less than 18 months ago. A contrarian perspective suggests that the rise in Central Bank rates that occurred in early 2022 sparked the end of easy money, and the corresponding retreat of most equities markets. Since then, the financial services industry has welcomed back an old foe – notably higher bank deposit rates. Companies and countries alike have also had to deal with higher borrowing costs which continues to erode their net results. The relief valve for this combined pressure has started to see the glacial increase in unemployment, and a corresponding slowdown in global consumerism. Locally we have just seen the recent adjustment to the Reserve Bank Act to assist in the fight against inflation. Despite these positive steps it is likely that these inflationary times will remain unabated for the foreseeable future. And yet the S&P500 index is up over 23% year to date, driven largely by the blue-sky aspirations of the 'Magnificent Seven'.

In the context of the New Zealand financial services industry, we have witnessed some interesting outcomes from this challenging environment. Offshore investment managers have started travelling to our part of the world in their droves, as available investment monies become increasingly

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harder to attract in their home countries. This increased traffic is presenting a first-hand view of the homogeneous nature of many of the product offerings, where price and scale is rapidly becoming their key points of difference. We have also observed some of our local fund managers declaring their enthusiasm towards owning more of the 'value chain' as support for their ailing investment capabilities starts to wane. The net result from both of these occurrences is an increasingly noisy industry whereby practitioners are needing the services of screening agents more than ever.

At the same time, our aging population is gradually morphing from asset gatherers to asset protectors with a household savings falling from $1.5 billion in December 2022 to $874 million – albeit with total deposits nearer to $195 billion. Consumer demographics also mirror the industry's dilemma with an average adviser age close to 60 years, supporting a heavily fragmented workforce, in an industry that continues to struggle to attract younger entrants. Those financial advisers who have at least ten years of service left in them will no doubt be able to cherry pick from a growing consumer base amidst an environment of declining financial practitioners.

The local industry remains challenged at outsourcing stuff – with many participants preferring to preside over the entire the entire wealth management process. This is partially driven by the historic ease of obtaining adequate investment returns without the need for robust analysis, and the relative absence of meaningful technology solutions. The technology zeitgeist will no doubt provide greater efficiencies for the industry to deliver their value proposition well, whilst enabling them to outsource components of their offering that add nominal value towards designing their client's lives. Technology will also expose those traditional elements of the value-chain that are over-priced and / or repeatedly fail to meet expectations. And yet, these easy access tools-of-the-trade will only whet the appetite for consumers to employ the guidance of the financial services industry.

Of course, all this industry upheaval will occur during a time where an ever-present regulator seeks to enhance the consumer experience through tighter regulations. Whilst the compliance life of all industry participants will undoubtably remain challenging, changing rules will create meaningful barriers for new industry entrants, albeit noting that the traditional way of hiring a financial advisor will no longer be based on geography. Moving forward, the new way of hiring a financial advisor will be based on specific areas of specialisation. As the predicted $30 trillion wealth transference settles in, the advice dispensing industry will need to cope with millennials. It is likely that this younger generation will seek monthly retainer models, where they are charged a fixed dollar amount rather than a percentage of assets under management.

All of this occurring at a time when the aggregation of financial advisors, while a concept that may seem appealing for its potential benefits in scale and resources, faces significant hurdles that make it unlikely to occur on a large scale. The nature of the financial advisory profession is deeply rooted in personal relationships and individualised service, which can be challenging to maintain at scale. Advisors often develop unique client-centric approaches that might not seamlessly integrate within a larger, standardised framework. Additionally, regulatory complexities and varying business models among advisory firms create obstacles to seamless consolidation. Trust, a fundamental element in financial advisory relationships, can also be difficult to transfer and maintain in a consolidated structure. Despite potential efficiency gains and resource pooling, the highly personalised nature of financial advisory services makes widespread aggregation a challenging prospect.

In summary, as the financial landscape evolves, financial advisors are facing the challenge of adapting to lower margins in their industry. With increased competition, changing client expectations, and advancements in technology, advisors must innovate their approaches to maintain profitability. Embracing technology will be crucial, allowing them to streamline operations, automate certain processes, and reach a broader client base more efficiently. Moreover, focusing on providing specialised, high-value services that differentiate them from automated platforms will be essential. Building stronger client relationships through personalised advice, tailored solutions, and comprehensive wealth planning will become the cornerstone of success. Embracing a more cost-effective operational model while emphasising expertise and personalised service will be key strategies for financial advisors navigating this landscape of tighter margins.

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