Commonwealth Business Review

April 2021

They Want to Do What?

Learn how to make sense of client behavior, so you can keep their financial plans on track.

33

How to Hedge

Zig when the market zags with these short-term tactics.

11

When SEP and SIMPLE IRAs Need to Grow Up

Have your clients outgrown their retirement plan? Learn the tipping points.

26

How Are You Doing?

As a task-oriented communicator, I tend to jump right into a conversation, forgoing the niceties about how someone's doing to get to the issue at hand.

Except that's not at all how I—or most of the people I've connected with—have approached emails and phone calls over the past year. It seems we've made a point to regularly ask, "How are you doing?"—and not in a rhetorical way. Although we've been pulled apart physically since March 2020, we've been drawn together in solidarity and shared concern for one another's health and well-being.

As we find ourselves in the late stages of this pandemic, and as the fatigue sets in, it's more important than ever to keep that focus on health and well-being—for ourselves, our clients, and our businesses. Kol Chu Birke, Commonwealth's managing principal of technology and corporate strategy, offers his perspective on our current predicament in this issue's editorial (p. 4) and shares guidance for investing in your physical and emotional health.

The prolonged uncertainty is likely weighing on your clients as well, and as Angela Sarver, senior practice management consultant, writes in our cover story (p. 33), "unusual times tend to widen the gap between advisors and client actions." If you find yourself more puzzled than usual by your clients' behavior, the techniques outlined in this article will help you make sense of what's influencing their choices and find solutions to keep them on track toward their goals.

Speaking of goals, there are a number of ways to help protect your clients' portfolios from a market correction. "How to Hedge: Tactical Strategies" (p. 11) explores the potential benefits—and risks—associated with inverse products, VIX ETFs, options strategies, and more, which can provide a short-term buffer from volatility.

And for your retirement plan business, you'll want to monitor the retirement security of your plan sponsor clients and plan participants, offering solutions for their evolving needs. In "When SEP and SIMPLE IRAs Need to Grow Up" (p. 26), learn to recognize the signs your clients may be better served by a more sophisticated plan.

We at Commonwealth continue to pour over the feedback you submit to us to understand how you're doing. In the meantime, we hope this issue provides you with new tools and perspectives to bridge the gap between where you are and where you want to be while we wait for a return to normal.

If you have questions, comments, or ideas for future stories, I'd love to hear from you. Email me at *kflood@commonwealth.com*.

Kate Flood

Kate Flood
Editor-in-Chief

There's more online!

Don't miss our exclusive online content (see p. 45) for even more valuable guidance from our subject-matter experts.

Contributors

Editor-in-Chief
Kate Flood

Supervising Editor
Becky Lucca

Staff Writers
Matthew Hurley
Elaine Mavrommatis
Miriam Schwartz
Maureen Shepherd

Copy Editors
Jeff Bruce
Wendy Chow
Martin Hwang
Caty Sacco
Demi Sperazza

Art Director
Breanne Hassett

Graphic Designer
Natalie Barlatier

April 2021

On the cover

They Want to Do What? Making Sense of Client Behavior

From recency bias to loss aversion, learn how to spot emotional queues in your clients' decision-making and develop strategies for keeping their plans on track.

Featured Articles

Investing

The Retirement Plan Advisor

Spotlights

Powering Through Mile 20

Kol Chu Birke, CFP®

Marathons have pretty predictable emotional stages for a majority of participants. Early on, runners are excited and enthusiastic—they've been training for months or years, and they're ready. The first 5, 10, and even 15 miles feel good (or at least manageable). But at some point, usually around mile 18 or 20, fatigue sets in. Everything gets harder, and they have to power through, putting one foot in front of the other, grinding ahead until they reach that 26.2-mile marker. That feeling of accomplishment, pride, and joy (and maybe a little bit of a runner's high) is what makes it all worth it.

Well, it seems we're at mile 20 of this pandemic. A year ago, when many of you were required to bring your work into your sometimes crowded homes and the market was plummeting, adrenaline helped you respond to your clients' and staff's concerns and needs. Through the spring and summer, you earned that honeymoon phase of client appreciation. But with the pandemic dragging on through the long months of winter, you may have found your energy and mood dipping.

> Top performers in any industry stay top performers through stamina, perseverance, and—most of all—an investment in their physical and mental health.

Although the human brain is designed to handle emergencies, it has trouble adapting to long-term uncertainty. So, whether you're still in the grips of this pandemic or have returned to some kind of normal, top performers in any industry stay top perfomers through stamina, perseverance, and—most of all—an investment in their physical and mental health.

Staying Healthy

Most runners don't complete marathons without training and investing heavily in their own physical and mental health. But they signed up for that challenge. We were tossed into something we surely didn't ask for. Still, there are steps we can take to stay healthy and power through.

Prioritize ruthlessly. Commonwealth's founder, Joe Deitch, once told me, "Eliminate 'medium' from your priority list. Only allow yourself to choose between 'high' and 'low,' and then focus exclusively on the high priorities."

Put your physical and mental health in the high-priority bucket. Much like you tell your clients to pay themselves first, you should make time for you. Do the things that ground and replenish you. Do not sacrifice that time.

Make healthy practices easier and unhealthy ones harder. Although healthy habits like sleeping and eating well are mostly common sense, that doesn't make them easy to incorporate. The best advice I've been given is to make the unhealthy habits more inconvenient and the healthy habits more convenient. For example, when I buy carrots, I immediately wash, peel, and cut them up for future snacking. Don't get me wrong—I also eat potato chips, but at least when the carrots are just as easy to grab, they stand a fighting chance. Similarly, when I have a phone charger by my bed, you can bet my phone will be right beside me. As such, I've moved my charger to the kitchen, so the phone doesn't keep me up (as often).

Do what rejuvenates you. I love mountain biking, gardening, cooking, woodworking, and even taking a walk while listening to a book on tape. These require enough focus that my mind doesn't drift back to work too often.

Create a new "commute." If you're working from home, create a habit that marks the end of each work day, much the way your commute did. This could be listening to a podcast, walking around the block, breathing deeply for a couple of minutes, or drawing a picture. You need something to help you transition from work to home.

Reach out for help and to help. I've felt stuck on a few projects recently, so I reached out to my teammates for help. They moved the projects along better and more quickly than I could have, and it was great to work together. Whether you need help with work or a shoulder to lean on, the act of reaching out will remind you that you're not alone and encourages others to do the same. The way the Commonwealth community cares for and about others is *the* reason I'm so grateful to have spent more than 20 years of my life here.

Deepening Client Relationships

From what I've heard, many clients have adjusted to the world as it is. Sure, they'd like to return to the life they're used to, but for the most part, they've settled in. This time of reduced travel and entertainment presents a great opportunity to deepen client relationships and forge new ones. Most people are now used to virtual get-togethers with family and friends, making it easier for you to connect with them remotely as well.

Staying Healthy in 2021

- Prioritize ruthlessly.
- Make physical and mental health a high priority.
- Pick healthy practices over unhealthy ones.
- Rejuvenate yourself.
- Create a new "commute."
- Reach out for help and to help.

For one-on-one conversations, these can be as organic and traditional as in-office check-ins or more reflective discussions. For younger clients, consider revisiting their goals, helping them articulate what really matters and what will bring true contentment. For older clients, it's a good time to work on their estate plans and perhaps even host some family meetings.

For webinars and other hosted conversations, you might invite a sponsor representative or local expert to speak on topics such as cybersecurity, health and wellness, or budgeting basics. You could also host a virtual paint-and-sip night, a yoga class, or even an online petting zoo for clients' kids and grandkids.

Leaning on Commonwealth

We exist to serve you so you can focus on helping your clients more fully and efficiently. There are so many resources available on COMMunity Link® to support you, your teams, and your clients, including the following:

- The Coronavirus Communications page, accessible from the homepage, includes timely, relevant resources for you and your clients.
- The newly launched Behavioral Finance page (within the My Practice tab) offers articles and interactive learning opportunities.
- The Financial Planning Playbook, which can be found under the Financial Planning & Research tab, offers a wealth of client-approved articles.
- The Compassion Fatigue page (My Practice > Practice Management) offers tips and support to those feeling worn down.
- The Online Education page (My Practice > Education) is your source for eLearning and user guides on Commonwealth's technology tools.
- Turnkey marketing materials, including daily social media posts and monthly articles of interest (My Practice > Marketing > Marketing to Clients), help you stay in touch with your clients.

Whether you want to reach a goal or are grappling with a new challenge, experts across the firm, from Practice Management to Advanced Planning, are here to help. And if you'd like to find a peer in the Commonwealth community to reach out to, check out Commonwealth Connect in the Community tab. Think of it as Commonwealth's version of LinkedIn, where you can search for and connect with others who have similar interests and business focus.

Heading Toward the Finish Line

Speaking for myself, it's been hard to be apart from you this past year. I'm used to the energy and camaraderie of connecting and sharing information with you at our conferences. While there are still some miles to go in this pandemic, I couldn't be more excited to power through and cross the finish line, so we can come back together as a community. Here's to a great 2021.

Kol Chu Birke is the managing principal of technology and corporate strategy. He is available at x9663 or at kbirke@commonwealth.com.

Positioning Portfolios for a Post-Pandemic World

Anu Gaggar, CFA®, FRM®

The COVID-19 crisis is the worst health emergency in a century, and its economic impact is just as steep. For some countries, the drop in GDP was the largest in several hundred years (since 1710 for the U.K.) or since World War II (1945 for Japan, 1946 for the U.S.), while at least one major country managed to eke out a little growth (China). But what does this mean for investors? How do we determine where to put our money in a post-pandemic world?

The Shortest Bear Market

By mid-March last year, more than 2,800 COVID-19 cases and 58 deaths had been reported in the U.S., three months after the virus was first identified in Wuhan, China. Just one week after Moderna submitted its mRNA vaccine candidate for clinical trials to the National Institutes of Health on March 16, 2020, the equity markets bottomed, with the S&P 500 dropping 34 percent from its February 19 peak. This bear market was the shortest in history—lasting just 33 days. While the economic damage had only just begun, the forward-looking equity markets already heralded the start of the post-pandemic recovery.

> Investors need to be mindful that potential increased antitrust enforcement, high valuations, and increased leverage and trading caused by financial innovations such as Robinhood could be signs that mega-cap technology stocks are overvalued.

Is It a Whole New World?

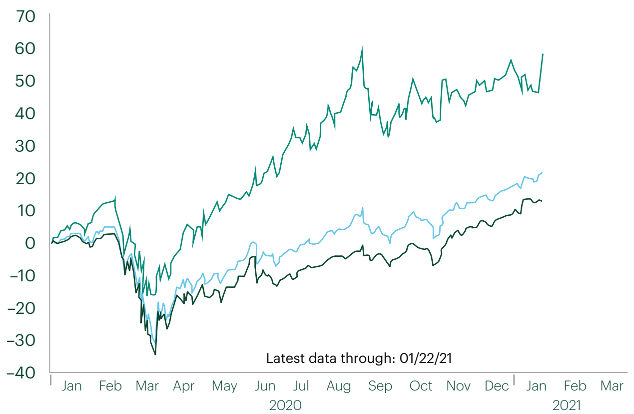
The world will likely emerge from this crisis looking very different. On the whole, however, it will probably resemble a magnified version of its previous self. Digital trends accelerated as our lives moved from our workplaces, schools, and everywhere else to the confines of our homes, and many of those habits will be here to stay. Big tech became an even bigger, more important part of our ecosystems. While travel and entertainment activities will look different, people will still get together, go places, and spend on experiences.

From an investment standpoint, a bulk of the easy money has already been made since the equity markets have factored in much of the reopening trade. So, investors need to be selective as economies recover and fundamentals catch up with valuations. These are some of the themes to keep in mind:

A more global, less China-centric world. For the past four decades, globalization has been one of the world's most powerful economic drivers, and China became a critical element in most global supply chains, resulting in the "Chinaization" of global trade. Strains between China and the rest of the developed world reached a high with the pandemic. As companies and countries deglobalize, they may retreat from a reliance on the country's supply chains—but not from the rest of the world. Quite simply, that move would not make economic sense. As supply chains diversify away from China, some might get reshored while others move to other shores.

Tech's power in numbers. The substantial growth of large technology companies like Facebook, Google, Amazon, Tencent, and Alibaba makes them powerful parts of the economic ecosystem and regular targets for debate about consolidated power and regulatory scrutiny. At the same time, COVID-19 reinforced outperformance by these index heavyweights. Easy monetary policy and pandemic-related winning products

Figure 1. Market Cap: FAANGM Performance Relative to S&P 500

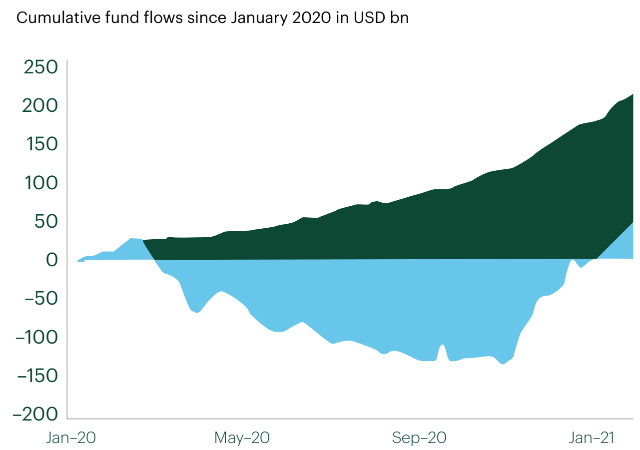


— Total (21.1)
— S&P 500 ex-FAANGM
— FAANGM (57.9)

FAANGM stocks include Facebook, Amazon, Apple, Netflix, Google (Alphabet), and Microsoft. Both classes of Alphabet are included.

Source: Standard & Poor's

Figure 2. ESG Funds Growing Steadily, Non-ESG Catching Up Recently



— All ESG Funds
— All funds excluding ESG

Source: EPFR, Goldman Sachs Global Investment Research

and services elevated their profitability in the near term, justifying their share price gains. It's possible that additional positive developments for these companies will exceed expectations, leading to further appreciation of their stock prices, but these will have to be unexpected changes not yet accounted for in the current stock prices (see Figure 1).

Nevertheless, investors need to be mindful that potential increased antitrust enforcement, high valuations, and increased leverage and trading caused by financial innovations such as Robinhood could be signs that mega-cap technology stocks are overvalued.

Feel-good investing is not just for good times. Environmental, social, and corporate governance (ESG) investing has seen an exponential rise in interest during the pandemic despite predictions that it would wither under tough market conditions. Since January 2020, ESG funds have received $215 billion net inflows from mutual fund investors globally (see Figure 2). This trend will likely continue.

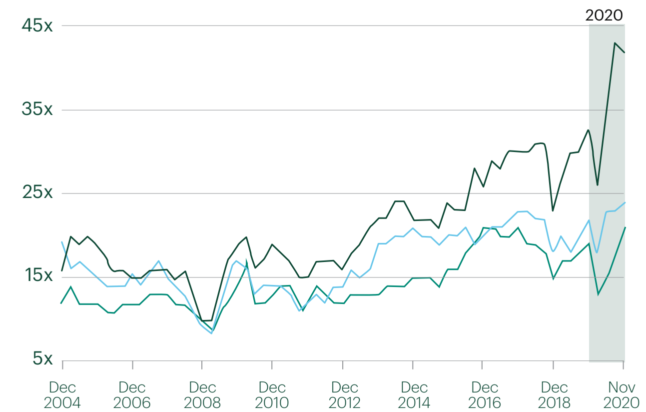
Starting this year, all Principles for Responsible Investment signatories must incorporate ESG considerations into at least 50 percent of their AUM, which currently totals around $100 trillion.

Performance of the ESG strategies has been supported by investor flows. Popular ESG indices such as the MSCI ACWI ESG Universal Index outperformed the mainstream MSCI ACWI Index by approximately 1.5 percent through the third quarter of 2020, and ESG-centric investment strategies generally performed well. It may be argued that the ESG funds were merely loading up on other well-established factors that also did well into the downturn, such as quality or low leverage. In time, a detailed risk attribution will be needed to tell us if there was any true "alpha" in ESG or if ESG was just borrowing returns from other factors.

Is the value resurgence sustainable? Before the recent market downturn, the valuation dispersion between growth and value was very wide, as is characteristic of a bubble period. Past recessions saw a pivot from momentum-winners into value names where there is support from dividend or book value.

This time around, performance of value factors was very poor early in the cycle, and the valuation dispersion widened further during the downturn, reaching an all-time peak. Resolution of several uncertainties in the latter part

Figure 3. MSCI USA Index: P/E Multiple Expansion in Highest Vs. Lowest Revenue Growth Quintiles, 2004–2020



— Quintile 5 (Fastest Growth)
— Quintile 4
— Quintile 1 (Slowest Growth)

Source: Bloomberg and GQG analysis, as of November 30, 2020

Figure 4. Number of Member Stocks of the Index: Russell 1000 Growth Vs. Russell 1000 Value

— Russell 1000 Growth Index
— Russell 1000 Value Index

Source: RBC US Equity Strategy, Bloomberg, as of end of November 2020

> While pent-up demand could reverse some of these trends as we emerge from the pandemic, once the initial surge wanes, consumers could return to some pandemic-period habits.

of the year led to a rotation into value, with many investors calling this the end of a decade-long onslaught on value (see Figure 3).

Certain traditional parts of value are structurally challenged and in a long-term secular decline, however, so we need to be careful of value traps. Another interesting phenomenon is a simple supply-demand dynamic in terms of the number of value and growth stocks. Figure 4 shows the number of stocks in the Russell 1000 Value Index versus the Russell 1000 Growth Index. The growth universe has shrunk in size to historic lows even as demand for growth stocks from investors is high. This could translate into higher asset prices for growth stocks and less differentiation among growth managers.

Consumer behavior. Some of the changes in consumer behaviors are likely to be sticky and accelerate secular trends that began even before the crisis, such as:

- People are spending more time at home—working from home, learning from home, eating at home, and traveling far less.
- There has been a rapid rise in online alternatives, with increased e-commerce penetration, internet TV adoption, and services such as telemedicine.

While pent-up demand could reverse some of these trends as we emerge from the pandemic, once the initial surge wanes, consumers could return to some pandemic-period habits (see Figure 5 on the next page).

Figure 5. What's the New Normal for Consumer Behavior?

Home
- **54%** more home cooking
- **22%** more home improvement

Shopping
- E-commerce saw **10 years** of growth in just **3 months**

Entertainment
- Netflix added **16M** subscribers in 5 months while Disney doubled its subscribers to **50M**

Health and Well-Being
- Online searches for telemedicine increased **9x** during lockdown

Work
- Rise in unemployment and remote working
- Zoom's user base grew from **10M** to **200M** in 3 months
- Slack's paying customers doubled

Learning
- Remote learning global user base grew **120%**

Travel and Mobility
- Tourism is grounded
- Air travel down **90%**

Media Consumption
- **39%** are reading more online news
- **43%** are watching more TV
- **40%** are using more social media
- **33%** drop in print media readership

Source: McKinsey & Company

So far, tech giants have benefited from these changes with rapid share price gains. These tech giants could also be the enablers for their successors. This could benefit smaller rivals not just in the U.S. but also in less developed countries, where the delta of growth is faster and greater.

Adjusting to the Post-Pandemic Age

The pandemic has sparked rapid development and evolution in just about every aspect of people's lives across the globe, and this has opened up new investing opportunities. By paying attention to these persistent themes, where companies, investors, and consumers are likely to shift behaviors, either for the short term or long term, advisors can position portfolios to help clients take advantage of the post-pandemic era.

Anu Gaggar is a senior research investment analyst. She is available at x7026 or at agaggar@commonwealth.com.

How to Hedge: Tactical Strategies

Brian McCormick, CIMA® and James McAllister, CFA®

With potential volatility ahead, you may want to zig when the market zags—be prepared to strategically buffer client portfolios with these short-term tactics.

In times of market uncertainty, tactical hedging strategies can provide the portfolio protection your clients need. Thanks to product innovations in recent years, there are a number of effective strategies that could help protect your clients' capital in the event of a market correction or downturn. Below, we explore the potential benefits of hedging, as well as some important caveats.

Inverse Products

Most inverse funds are ETFs that track a particular index, such as the widely used ProShares UltraShort S&P 500 ETF (SDS). Each day, an inverse ETF (known as a −1x product) resets its exposure to the underlying index, seeking to provide investors with the exact inverse of the

Figure 1. Performance of ProShares UltraShort S&P 500 ETF

	1 Year (As of 9/14/20)	
S&P 500 Index	14.68%	
ProShares UltraShort S&P 500 EFT (SDS)	–44.95%	–3.06X

	1 Month (As of 9/14/20)	
S&P 500 Index	0.49%	
ProShares UltraShort S&P 500 EFT (SDS)	–2.10%	–4.29X

Source: Morningstar Workstation

target's daily performance. But the daily compounding of returns can cause the ETF's long-term performance to deviate from its target.

Leveraged inverse products, such as –2x and –3x inverse ETFs, seek to magnify their performance by the indicated factor. The leverage factor can also cause deviations—sometimes substantial—from the target's performance. This is especially true through periods of heightened volatility, such as September 2020, as the data in Figure 1 demonstrates.

Commonwealth's policies. To use products, you must first complete a training course. You must also agree to send clients using inverse products a disclosure letter outlining the risks and track the daily performance of any inverse product you recommend.

Key consideration. Although inverse products can be useful in certain short-term situations, remember that holding them for weeks or months can result in the performance of a –1x, –2x, or –3x product severely deviating from its target—and ending up looking like something else entirely.

VIX–Related Products

These products track the CBOE Volatility Index (VIX), which typically rises when markets sell off. Advisors often ask us whether VIX ETFs will rise when the VIX does. The answer is they might, but only over very short periods of time. Why? It's important to understand that VIX-related products *don't* track the spot price (the current quote) of the VIX; instead, they invest in VIX futures products, which are completely different from the VIX itself.

The price movement for VIX futures also differs from that of other futures contracts. Typically, a futures price will converge toward the spot price as a contract approaches expiration. But VIX futures contracts are typically in a state of *contango*, meaning the futures price is higher than the spot price. That's because the markets are usually anticipating a spike in volatility at some point in the future. Accordingly, prices for VIX futures contracts are almost always higher than the spot price of the VIX.

VIX-related products such as the ProShares VIX Short-Term Futures ETF (VIXY) continually buy and sell near-term VIX futures contracts. These contracts naturally move downward to the spot price as the contract heads toward expiration. When a contract is close to expiration, the fund will sell it and buy another at a higher price. That means VIX-related funds are consistently buying high and selling low. This practice erodes the performance of these funds over time, which is why they make very poor long-term hedges.

Key consideration. It is possible for VIX-related products to work very well over a short period if the timing is right and the product is purchased immediately before the spike. Generally, these brief spikes in volatility only last a few days or a couple of weeks. Accordingly, Commonwealth has a 30-day holding period limit on VIX futures–related products.

Options Strategies

Protective puts. A put option gives the holder the right—but not the obligation—to sell the underlying stock at a predetermined strike price until a specified expiration date. Based on client preferences, you choose the strike price and expiration date. Because this strategy protects against losses below the strike price, it's often referred to as portfolio insurance. The cost of option premiums can be a major hurdle for investors, however, especially in periods of heightened volatility, when premiums may become more expensive.

Important Caveats and Key Considerations

Inverse Products
They can be useful in certain short-term situations.

VIX–Related Products
These products work very well over a short period if the timing is right.

Options Strategies
The put will not create a perfect one-for-one hedge, but it can provide a buffer against potential losses.

Buffered ETFs
The upside potential will vary based on the ETF's buffer percentage and the year-to-year volatility between resets.

Low–Volatility ETFs
SPLV may be more volatile than USMV.

Cash Toggle Strategies
In a prolonged bear market, such as the one we saw from 2007 to 2009, these funds could potentially protect investors' capital.

Managed Futures
They have been able to protect capital over longer periods of time by providing diversification and reducing drawdowns.

Collars. This strategy can reduce the costs associated with protective puts. A collar involves selling a call, in addition to buying a protective put. The premium collected from selling the call offsets some or all of the expense of the put. This strategy comes with caveats, however. First, though a collar hedges a position's downside, it also caps the upside. Each time the price of the underlying position goes above the exercise price, the cost of the negative short call position increases. Second, if the stock price goes above the exercise price, the call purchaser can exercise the option.

At that point, the seller has to deliver the appropriate number of shares. Sometimes, these situations can be settled in cash, but this solution may force the sale of the underlying position, which could trigger capital gains. If you've decided to hedge specifically to avoid realizing gains, additional transactions may be necessary to avoid creating a large tax bill; for instance, you might buy back the call to close out the position, thus potentially raising the costs involved.

Key consideration. Holding a protective put represents a true hedge on an individual stock position. To provide portfolio diversification, you might purchase a put on one or more index ETFs that closely represent the underlying holdings in a client's portfolio. The put will not create a perfect one-for-one hedge, but it can provide a buffer against potential losses.

Buffered ETFs

Options-based ETFs are typically linked to the performance of an equity index with a buffer that limits an investor's downside. Each options-based ETF has a defined buffer that resets on a periodic basis, which is typically one year. To receive the full benefit of the buffer, the ETF must be held for the entire period between resets. For example, a buffered ETF tied to the S&P 500 with a 10 percent buffer and a January 1 reset date must be held from January 1 through December 31 to maximize the benefit. If the S&P 500 declines by less than 10 percent during the year, an investor should receive the investment principal less the expense ratio at the end of the year.

Any losses beyond the 10 percent buffer will be incurred by the ETF. The advertised buffer will be in effect only if the ETF is purchased on the reset date. Because options are used to provide exposure to the index, they will not track the index on a one-to-one basis during an interim period. The pricing of the ETF's underlying options—and, therefore, the price of the ETF—can fluctuate based on the volatility of the index, interest rates, and the options' time to maturity.

Key consideration. In exchange for downside protection, the investor's upside is capped, based on the cost of the options required to implement the downside buffer. The upside potential will vary based on the ETF's buffer percentage and the year-to-year volatility between resets. It's also important to note that these products will usually track the *price return* of an index rather than the total return. As a result, returns may be slightly lower than the total return index before hitting any upside cap associated with the ETF.

> Holding a protective put represents a true hedge on an individual stock position.

Low-Volatility ETFs

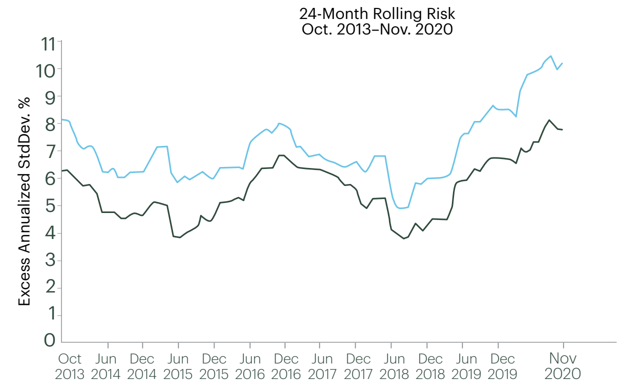
These products have been an extremely popular way for investors to get downside protection. Among the many low-volatility products available, the iShares MSCI USA Min Vol Factor ETF (USMV) has been the most popular. This fund is designed to provide the lowest return variance for a given covariance matrix of stock returns. (A covariance matrix indicates the direction of the linear relationship between two variables.) The USMV's underlying MSCI Minimum Volatility Index is calculated using the Barra Optimizer to optimize a given MSCI parent index for the lowest absolute volatility within a certain set of constraints. By comparison, the Invesco S&P 500 Low Volatility ETF (SPLV) takes only standard deviation into account.

Key consideration. Over the past five years, both of these ETFs have provided solid downside protection with down-market capture ratios in the 65 percent range. But the SPLV may be more volatile than the USMV (as seen in Figure 2) due to larger-sector bets the SPLV sometimes makes in areas such as utilities.

Cash Toggle Strategies

"Cash toggle" may not be the official term for the strategies discussed below, but the term describes the ability of certain funds to move in and out of cash or

Figure 2. 24-Month Rolling Risk: SPLV and USMV



— Invesco S&P 500 Low Volatility ETF
— iShares MSCI USA Min Vol Factor ETF
Source: MPI Stylus

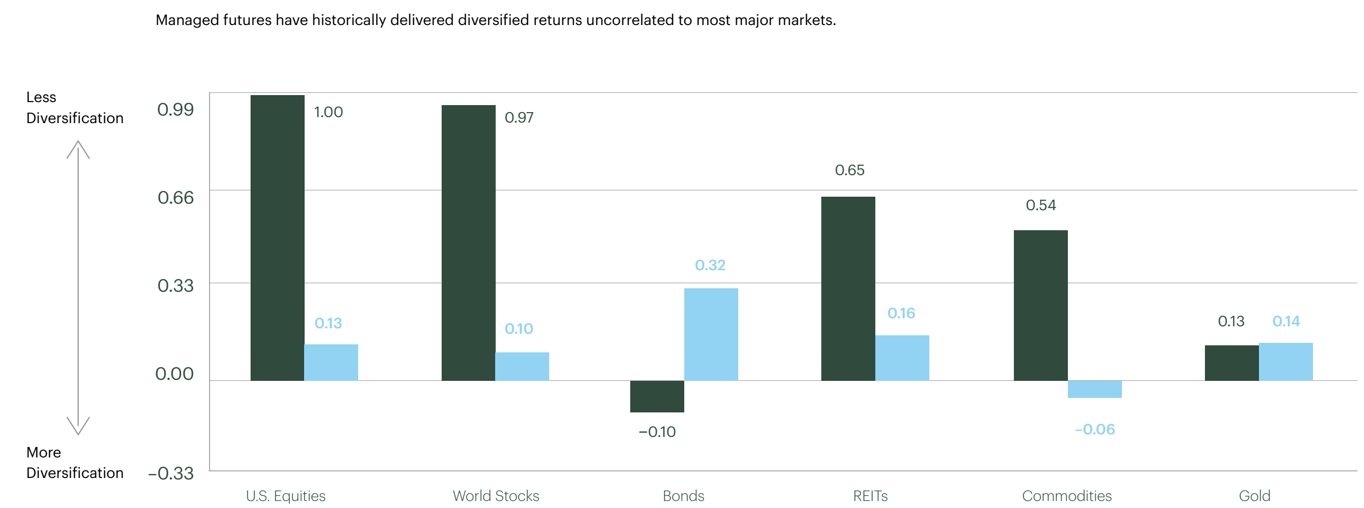
other asset classes. The Pacer Trendpilot Large Cap ETF (PTLC), for example, is designed to provide investors with 100 percent equity exposure while markets are trending up, but they can also cash in on market declines, based on the 200-day simple moving average. On the other hand, the VictoryShares US 500 Enhanced Volatility Weighted ETF (CFO) tactically reduces equity exposure during significant market declines and reinvests on further declines or when markets have rebounded.

Commonwealth's PPS Select Moving Average (Active) Model Portfolio employs a momentum-based strategy while also incorporating the 200-day moving average. It seeks steady capital growth while attempting to limit downside exposure by moving in and out of three core asset classes: equity, fixed income, and gold. The maximum allocation for each core asset class is 33 percent, but the portfolio could allocate up to 100 percent to cash equivalents if market conditions warrant. The model's goal is to limit return and drawdown risk during market downturns. (A drawdown is an investment's peak-to-trough decline during a specific period.)

Key consideration. Both the PTLC and the CFO seek to provide downside protection in bear markets. When markets are choppy, however, exhibiting brief drops followed by quick recoveries, these funds' performance could lag due to selling too late in the downtrend and buying too late in the recovery. In a prolonged bear market, however, such as the one we saw from 2007 to 2009, these funds could potentially protect investors' capital.

> In a prolonged bear market, such as the one we saw from 2007 to 2009, the PTLC and CFO funds could potentially protect investors' capital.

Figure 3. Lower Return Correlations for Managed Futures



■ U.S. Equities
■ Managed Equities
Source: Morningstar Direct, as of September 30, 2020

Managed Futures

Alternative asset classes, though not a pure hedge, could provide additional portfolio diversification through lower correlations to equity markets. Managed futures, in particular, have historically had a very low correlation to equities and other major asset classes (see Figure 3).

Key consideration. As with cash toggle products, managed futures have been able to protect capital over longer periods of time by providing diversification and reducing drawdowns.

Commonwealth's Resources

If you'd like additional information about the strategies described above, Commonwealth's Investment Management and Research team is ready to assist you. Contact us at x5094 or at *investmentresearch@commonwealth.com.*

We're also here to help our advisors with simpler asset allocation and strategy decisions. So, whether you're looking for hedging strategies, simple tweaks, rebalancing advice, or product recommendations, we're always ready to discuss downside protection for client portfolios.

Brian McCormick is manager, investment management and research. He is available at x9367 or at bmccormick@commonwealth.com.

James McAllister is director, equity research. He is available at x9660 or at jmcallister@commonwealth.com.

Harness the Potential of ESG Investing

Peter Essele, CFA®, CAIA, CFP® and Sarah Hargreaves

Over the past 10 years, environmental, social, and governance (ESG) investing has evolved from a niche investment style to a prominent focal point in our industry. Demand from investors is widespread, as evidenced by the proliferation of sustainable investment products, particularly from many historically *traditional* managers. BlackRock, for instance, saw its iShares ESG suite of ETFs grow by $20 billion in 2020, according to Morningstar.

In keeping with this dramatic shift, ESG has become one of the most popular discussion points with our advisors. To help you navigate the space, Commonwealth remains committed to providing a wealth of ESG products and informational materials. This article offers guidance on how to use our many resources to get started—and sustainably integrate—this burgeoning investment style into your practice.

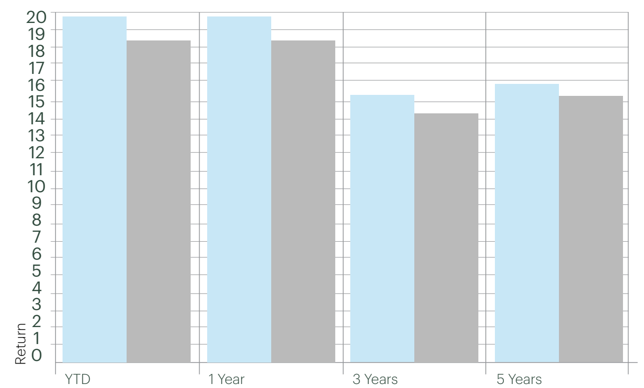
The Case for Performance Parity

Some skeptics might dismiss ESG investing, believing that incorporating its standards and principles would lead to underperformance compared with traditional investment strategies. Recent data suggests otherwise, however. As shown in Figures 1, 2, and 3, ESG indices outperformed their traditional counterparts across various regions and time frames—regardless of the country of domicile. Based on these wide-ranging performance comparisons, it's clear that ESG investing offers competitive performance.

A Plan for Broaching ESG Investing

Appetite for sustainable investments is particularly prevalent among women and millennial investors. These two cohorts tend to view ESG investing as a way of expressing their values or making an impact, yet only 41 percent of financial advisors are proactive in initiating ESG discussions with clients. Take advantage of that vacuum, meet your clients' ongoing expectations, and differentiate your services by

Figure 1. S&P 500 ESG TR USD Vs. S&P 500 TR USD (1936)



S&P 500 ESG TR USD | S&P 500 TR USD (1936)

Source: Morningstar Direct, as of December 31, 2020

broaching the subject of sustainable investing. Follow our best practices to get started.

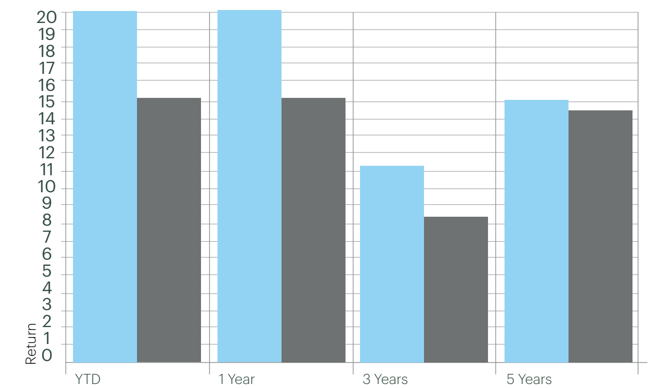
Get educated. To enhance your sustainable investing knowledge, check out our advisor resources on COMMunity Link® at Products > Investment Products > Overview > Mutual Funds, then select Socially Responsible/ESG Investing beneath Recommended Resources. From educational handouts and terminology glossaries to in-depth reference guides, we have you covered. Once you have a clearer understanding of the space, you'll be better prepared to raise ESG investing with your clients.

Initiate a conversation. Be proactive and ask your clients if they have heard of ESG investing or if they have an interest in learning more. Not only is this a great way to bring up the subject, it also allows you to engage with your clients on their financial goals and priorities.

Stick to the basics. When framing the advantages of sustainable investing, it's best to keep it simple. By using an ESG framework, investors can gain a more holistic understanding of how a company operates. You can also mention how ESG factors can help mitigate risks by identifying high-quality companies with sustainable business models—key drivers of long-term outperformance.

Keep it personal. Go the extra mile and tailor the conversation to the issues your clients care about most. You can even provide relevant examples or data to further set the stage. Either way, personalizing the message will help you effectively reach your clients.

Figure 2. MSCI EAFE ESG-Leaders NR USD Vs. MSCI EAFE NR USD



MSCI EAFE ESG-Leaders NR USD | MSCI EAFE NR USD

Source: Morningstar Direct, as of December 31, 2020

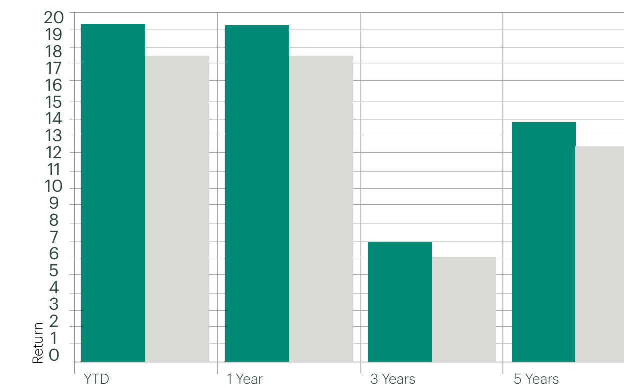
Be prepared for questions. Since clients may have little exposure to this space, be ready to answer their questions. Some may wonder how to incorporate ESG into an existing financial plan; others may be concerned with performance.

Get connected. Join other Commonwealth advisors who share an interest in the space by adding ESG Investing to your Commonwealth Connect profile. Access your profile by navigating to Community > Commonwealth Connect > My Profile on COMMunity Link® Then, scroll down to the Investment Strategy section and select **ESG Investing**. Once you've set up your profile, you'll also want to check out our "Start Connecting" networking tool, which can also be found on the Commonwealth Connect page on COMMunity Link. This tool allows advisors and their staff to share profiles and search for others by location and common interests (business and personal).

Commonwealth's Commitment

In addition to providing the necessary educational resources for advisors, Commonwealth has pledged an internal commitment to embrace ESG principles throughout the organization and community. The newly formed Corporate Social Responsibility committee consists of internal employees whose mission is to assess Commonwealth's ESG efforts and identify areas for improvement. In addition, the group hopes to foster awareness and invoke positive long-term change. The team's efforts were further bolstered by the recent hiring of Scarlett Abraham Clarke, vice president, chief diversity and

Figure 3. MSCI EM ESG Leaders NR USD Vs. MSCI EM NR USD



MSCI EM ESG Leaders NR USD | MSCI EM NR USD

Source: Morningstar Direct, as of December 31, 2020

inclusion officer, who is dedicated to planning and directing all aspects of Commonwealth's diversity commitments.

A Mainstream Investing Style

We're pleased to announce the PPS Select SRI/ESG portfolios celebrated their 10-year anniversary in September 2020, with client commitment totaling $400 million. This significant milestone was further substantiated by a 44 percent increase in year-over-year new account inception growth. To support your interest, we recently launched a quarterly sustainable investing newsletter to help advisors and their clients understand the impact of investments in the PPS Select SRI/ESG models. Additional client-approved ESG resources will be available over the coming months, so stay tuned!

We encourage you to learn more. Please reach out to Peter Essele or Sarah Hargreaves to hear about all the ways Commonwealth can assist you in your ESG efforts.

Peter Essele is vice president, investment management and research. He is available at x9627 or at pessele@commonwealth.com.

Sarah Hargreaves is an investment management analyst. She is available at x7182 or at shargreaves@commonwealth.com.

Allocations to Alternatives for High-Net-Worth Investors

Nate Parker, CFA®, CAIA, and Rob Kane, CAIA

How can you capture the right mix of investment opportunities for high-net-worth (HNW) clients? We frequently get inquiries on this topic from advisors interested in the evolving landscape of alternative investments. In response, our Alternative Investments team created a framework for incorporating nontraditional asset classes, strategies, and products into client portfolios. It's designed for HNW investors, as investment minimums are high (e.g., $50,000) for some vehicles, such as private equity. But the model allocations we developed could also be used for customizing portfolios for a wider client base.

A Framework Informed by Data

To determine which investment allocations will work best for your HNW clients, we used the following data sources:

- A study of the global investment universe for each asset class from a market cap and AUM perspective
- Research into how much institutional investors (e.g., endowments and pension funds) allocate to alternatives
- Commonwealth's liquidity and suitability guidelines for nontraded products
- Product availability at Commonwealth

We assessed historical and qualitative analysis of returns, correlations, volatility, and downside risk metrics for the major asset classes suitable for HNW investors. Based on our insights, we found six asset classes to be most beneficial for our framework.

Overall Allocation Strategy

Figure 1 shows our recommended total alternative investment allocation by portfolio model. The total allocation starts at 10 percent for the Primarily Fixed Income model and progressively increases until it reaches 20 percent for the Equity model. This strategy is based on an investor's expected risk appetite, time horizon, and near-term liquidity needs for each of the five models. Below, we explore the reasoning for our asset allocations and specify recommended investment vehicles.

Gold. Our recommended allocation is 2 percent across all five models. Gold's suitability includes an equity-like return profile, defensive characteristics, inflation protection, and a low correlation with other asset classes. Gold can serve as a store of value or safe haven during periods of economic or geopolitical distress.

Physical gold ETFs are our preferred investment vehicles because they effectively track the spot price of gold (minus expenses) by storing gold bullion in vaults. Desirable characteristics also include strong liquidity and competitive expense ratios. Investors should be aware that physical gold ETFs are structured as grantor trusts and considered a collectible for tax purposes. Their long-term gains are taxed at a maximum federal income tax rate of 28 percent. If shares are held for one year or less, gains are taxed as ordinary income.

Figure 1. Asset Allocation Percentages by Model

	Primarily Fixed Income	Balanced Fixed Income	Balanced Equity	Primarily Equity	Equity
Gold	2.0	2.0	2.0	2.0	2.0
Hedge funds	2.0	2.0	2.5	3.5	4.5
Infrastructure	0.0	2.0	2.5	3.0	3.0
Private credit	2.0	2.0	0.0	0.0	0.0
Private equity	0.0	0.0	3.5	4.5	5.5
Real estate	4.0	4.5	4.5	4.5	5.0
Total	10.0	12.5	15.0	17.5	20.0

Hedge funds. Our recommended allocation starts at 2 percent for Primarily Fixed Income and increases for models with higher risk profiles. Suitable products are available across the wide risk/return spectrum.

We recommend isolating investment vehicles to mutual funds and limited partnerships (LPs). Depending on the manager's strategy, mutual funds can deliver returns similar (correlated) to those of a private investment structure. Mutual funds may cost less for investors because they *generally* do not charge a performance fee. Global macro or long/short equity are two examples of trading strategies where a mutual fund's lower costs and daily liquidity may be beneficial, while resulting in little alpha loss compared with the LP structure.

An LP seeks to drive returns through use of high amounts of leverage and illiquid assets. In an LP structure, the manager has no restrictions on using these assets. In comparison, mutual fund portfolios are restricted to no more than 15 percent in illiquid assets.

Infrastructure. Our recommended allocation starts at 2 percent for Balanced Fixed Income. It increases for models with higher risk profiles because infrastructure funds primarily invest in equity securities. Infrastructure was excluded from Primarily Fixed Income to limit equity market risk.

Actively managed mutual funds are our preferred investment vehicles because they employ a stricter definition of infrastructure than that used by passive indices. Active managers focus on pure-play companies that operate infrastructure assets globally across communications, transportation, and utilities segments. Active managers typically limit or exclude cyclical companies (e.g., construction, equipment, materials, and pipelines) and emerging markets. This strategy generally creates more stable cash flows and a more favorable risk/return profile.

Private credit. Our recommended allocation is 2 percent for Primarily Fixed Income and Balanced Fixed Income. Because this asset class is more suitable for investors primarily seeking income, it was excluded from other models.

Recommended investment vehicles include mutual funds and limited-liquidity structures, such as interval funds, LPs, and limited liability companies (LLCs). Products generally achieve high levels of income by using relatively illiquid positions, leverage, complex strategies, and/or securities. Accordingly, limited-liquidity vehicles are the preferred structures. Mutual funds may have comparatively lower returns or experience higher volatility due to investor selling.

Private equity. Our recommended allocation starts at 3.5 percent for Balanced Equity. As capital appreciation is the primary objective, the allocation increases for models with higher risk profiles.

> We recommend isolating investment vehicles to mutual funds and limited partnerships (LPs).

LPs or LLCs are our preferred investment vehicles. Given the long-term holding periods for private equity (typically 10–15 years), this asset class has a favorable tax structure. An LP or LLC is treated as a pass-through entity for profits and losses, so federal taxes apply only at the investor level. Investors have limited liability, meaning the most they can lose is their total investment in the fund.

Real estate. Our recommended allocation starts at 4 percent for Primarily Fixed Income. It increases for models with higher risk profiles. The investment universe includes many suitable products across the risk/return spectrum.

Preferred investment vehicles encompass liquid ETFs and mutual funds, as well as limited-liquidity and illiquid nontraded products that invest in private real estate markets (e.g., interval funds, NAV REITs, LLCs, and LPs). Evaluation of a product's security and suitability should include an investor's goals, risk tolerance, time horizon, and liquidity needs. The underlying investment instruments and property type exposure vary dramatically by product structure and investment strategy.

Key Takeaways

- Before using our allocation models, determine the desired investment characteristics, liquidity needs, and risk tolerance for each suitable client. When

Figure 2. Asset Class Investment Objectives

	Diversifier	Income	Inflation Protection	Return Enhancer	Risk Mitigator
Gold	✓		✓	✓	✓
Hedge funds	✓			✓	✓
Infrastructure		✓	✓	✓	
Private credit		✓			
Private equity				✓	
Real estate	✓	✓	✓	✓	

selecting securities, you should consider the product structure, investment strategy, management team, liquidity profile, fee structure, and use of leverage. Figure 2 summarizes the primary investment objectives for the asset classes in our framework.

- Keep in mind that manager dispersion (i.e., variance between top- and bottom-performing funds) can be much higher for alternative investments compared with traditional stock and bond funds. Accordingly, manager selection is critical.

Resources Designed for You

Commonwealth's Alternative Investments team is always ready to help you with the asset allocation, security selection, and investment monitoring process for alternative investments. You'll also find valuable resources on COMMunity Link® in the Products > Investment Products section, including the following:

- To find products available on our nontraded platform, as well as information about the product structures, required training programs, and regulatory bulletins, go to our Alternative Investments page.
- To access our ETF Reference Guide, visit our Exchange Traded Funds page.
- To access our Mutual Fund Recommended List, go to the Mutual Funds & Rec. List page.

Nate Parker is a senior investment research analyst. He is available at x5952 or at nparker@commonwealth.com.

Rob Kane is a senior investment research analyst. He is available at x9673 or at rkane@commonwealth.com.

Closing Up the Qualified Savings Trap for Long-Term Care

Bryan Langdon, Ash Brokerage

The rising costs and need for long-term care (LTC) make it a pressing issue that's ideally addressed when developing comprehensive financial plans. For clients who store the bulk of their retirement savings in IRAs and 401(k)s, special considerations need to be made to avoid the "qualified savings trap" when the time comes to pay for costly expenses related to a nursing home stay, 24/7 home care, and the like.

The Rising—and Unforeseen—Costs of Long-Term Care

LTC costs often outpace health care inflation, and according to a recent Genworth study, costs for LTC support services rose by 3 percent to 6 percent in 2020. As these costs continue to rise, our aging population lives longer and consumes an increasing amount of care. Add to that the impact of the COVID-19 pandemic, and it's safe to say that securing quality LTC will continue to become more expensive.

To pay for it, some clients with qualified retirement plans may turn to those taxable funds. This could lead to higher tax brackets, higher Medicare premiums, and other negative financial consequences. In addition, they could end up spending those retirement savings much faster than planned, possibly leaving their remaining partner with a diminished nest egg. (The remaining partner deserves attention, too—on top of potentially having fewer resources to use, this spouse may not have the same support network available.)

Fortunately, while using qualified funds for long-term care presents some challenges, there are some extremely effective insurance solutions to consider, and today's options are more viable than those of the past.

Understanding the Tax Consequences

When talking about using qualified funds for LTC, some advisors assume they can simply offset the additional income with deductions for qualified LTC expenses. But the deduction for medical expenses is only available in certain situations. While nursing home expenses are generally fully deductible, custodial expenses like adult day care, home care, or assisted living may not be if those services were not medically directed.

To really understand who does—and doesn't—benefit from the deduction, it's helpful to look at an example. Figure 1 below is a simplistic hypothetical comparing how a married couple with $100,000 of adjusted gross income (AGI) would be taxed if they took a standard deduction or if they withdrew $30,000 from qualified funds—raising their AGI by 30 percent—to cover a long-term care need.

With the extra qualified fund withdrawal, the couple experienced an additional $30,000 in taxable distributions and paid an additional $6,000 in taxes, even though they were able to deduct medical expenses. Effectively, they lost the value of the deduction, and you might be wondering why.

Figure 1. No LTC Vs. LTC from Qualified Funds

	No LTC	$30K LTC (From Qualified Funds)
AGI	$100,000	$130,000
Deduction	$24,800 (standard)	$25,250 ($20,250 of medical expenses + $5,000 miscellaneous deductions)
Taxable income	$75,200	$104,750
Net tax paid	$8,629	$14,625

Two limiting factors create this tax trap. First, medical expenses can only be deducted to the extent they exceed 7.5 percent of the clients' AGI. Second, the clients must itemize deductions. In this example, the couple's $30,000 in qualified care creates a deduction of $20,250, which, in addition to $5,000 of additional deductions, would net them a total deduction of $25,250. With a standard deduction of $24,800, the benefit of itemizing is negligible.

> Clients who will have to take RMDs soon, or are taking them now but don't need the income, can consider directing those proceeds into a traditional LTC policy.

When looking over insurance solutions, you'll find that in most cases you won't be able to avoid taxes entirely, but you can spread out the taxable event while creating income tax–free long-term care benefits immediately.

Product Solutions for Qualified Dollars

One option to consider is OneAmerica's State Life Asset Care. This plan allows your clients to roll over a portion of their retirement account to an IRA-deferred annuity. Then, from the annuity, a withdrawal is taken annually to seamlessly fund a 20-pay linked-benefit LTC policy covering either a single person or a couple. These annual withdrawals are taxed as they are made and count toward your clients' RMDs.

If you prefer to use a different LTC product, you can use this same concept and fund an IRA annuity to purchase a 10- or 20-pay linked-benefit LTC policy. Nationwide, Securian, Lincoln Financial, and Pacific Life all offer flexible funding options for their linked-benefit LTC policies. In fact, keep an eye out for information on Lincoln's new variable MoneyGuard plan, arriving early this year.

Clients who will have to take RMDs soon, or are taking them now but don't need the income, can consider directing those proceeds into a traditional LTC policy. Many advisors dismiss traditional plans because their clients have experienced in-force rate increases on policies sold more than 10 years ago. Offerings on the market today, however, are much better priced as insurance companies have learned from the past and adjusted their premiums and benefits. So, you should expect greater rate stability with today's plans.

Help Your Clients Avoid the Trap

Spend some time educating your clients on the qualified savings trap as it relates to their future long-term care needs. They're likely aware of the need for planning if they've witnessed any family members or friends go through an LTC event and experience the effects. By using available solutions, you can help them properly plan for the possibility of a similar event happening to them.

Bryan Langdon is national spokesperson, disability income/long-term care, at Ash Brokerage. He is available at 260.434.9742 or at bryan.langdon@ashbrokerage.com.

Soup to Nuts: What You Need to Know About the Path to Fee-Only

Erin Esposito

Where do you see your practice going 5, 10, or 15 years down the road? For nearly two decades, the industry has been trending toward an advisory model—and, as you think about the future of your business, the prospect of making the move to fee-only may hold some allure. It can be a business- and life-changing move, so knowing what to expect can make all the difference in ensuring a smooth transition for you, your staff, and your clients.

Let's take a look at Commonwealth's fee-only affiliation models and explore two advisor scenarios to illustrate what you can expect along the way.

> Formalize the fiduciary **responsibility** with clients.

Flexible Fee-Only Choices

Commonwealth offers the option to affiliate as an IAR of our corporate RIA or as your own RIA.

IAR-only. With the IAR-only affiliation, you drop your FINRA licenses and operate fully as a fiduciary as an IAR of Commonwealth's RIA, conducting business through Commonwealth's advisory program and consulting agreements. The minimum requirement to affiliate under this model is $50 million in Preferred Portfolio Services® (PPS) AUM.

This affiliation model is the most popular choice among Commonwealth advisors. It offers appeal because of the ease of transition and minimal disruption to clients. If you choose this path as a Commonwealth advisor, you will still have access to the same technology, infrastructure, and support you currently enjoy, with the added benefit of having Commonwealth perform the compliance responsibilities of an advisory practice—without taking on any compliance maintenance or risk.

RIA-only. If you choose the RIA-only affiliation, you also drop your FINRA licenses, but you're responsible for creating and using your own advisory program and consulting agreements (in some instances, you may still use Commonwealth's agreements). You continue to use Commonwealth as an infrastructure provider and access all the services you're used to, including wealth management, marketing, practice management, and more. This affiliation requires a minimum of $100 million in advisory AUM.

Although the RIA-only affiliation offers more freedom, it's a complex transition that requires more paperwork and client involvement. RIA-only advisors at Commonwealth can continue to access Commonwealth's technology and infrastructure, while assuming the primary responsibility and risk of the compliance and regulatory obligations of running an RIA firm.

Tales of Two Glide Paths

To understand why firms make the transformation, let's examine the glide paths of two offices that have moved to fee-only, including the factors leading up to their transitions and what their businesses look like today. (Although these are fictional cases for illustrative purposes, they are compilations based on actual Commonwealth advisors who moved to fee-only models.)

The IAR-only glide path. Scott Planner joined Commonwealth as an independent advisor about 17 years ago after leaving a wirehouse. His two adult children have joined his practice, and, while he has no plans to slow down, he's thinking about the future.

A voracious reader of industry news, Scott's interest in going fee-only piques after speaking with several other Commonwealth advisor friends who already made the move. Scott sees himself as a fiduciary but wants to formalize that responsibility with clients. His strongest motivation, though, is creating a succession plan now that his two children, his likely successors, have joined his practice. Both have completed the CERTIFIED FINANCIAL PLANNER™ professional certification and are interested in evolving the practice to fee-only.

When Scott initiates discussions with Commonwealth in 2018, he has $125 million in AUM, $118 million of which is in PPS. His practice has a strong focus on financial planning, and he still uses just a few legacy commission products. Preliminary calls with Commonwealth's RIA Services team members are consultative; they offer the opportunity to ask questions and have an open discussion to ensure that a fee-only approach is the right option for Scott and his practice. By September, after several conversations, Scott has made the decision: an IAR-only affiliation with Commonwealth is a straightforward, streamlined option for him, but he wants to complete the transition by year-end to avoid state licensing fees.

> Being fee-only might create **opportunities** to acquire other RIA entities.

The transition to IAR-only is generally quick, taking three to four months on average—and Scott's transition is relatively simple, with the entire process taking three months. Most of Scott's business is currently held in PPS, and no account number changes or repapering are required because all business stays within Commonwealth's PPS program—which translates to minimal disruption to clients.

The process begins with a planning call with the RIA Services transition team to establish a comfortable timeline. In the three months that follow, Scott and his team:

- Work through their accounts and gather the forms needed for any nonadvisory business
- Collaborate with Practice Management on messaging to communicate the change to clients
- Update marketing and branding materials to reflect their new affiliation

By his target "affiliation change day," Scott has received the necessary forms back from his nonadvisory business. The Commonwealth Licensing team files a partial Form U5, terminating Scott's FINRA Series 7 securities registration. Scott's firm is officially operating as IAR-only.

Today, two years later, Scott's fee-only practice is thriving. For this office, the choice of an IAR-only affiliation was the simplest way to operate fully as a fiduciary and eliminate the nuances of FINRA. The practice is attracting new clients and has increased its client minimum. Scott and his staff work closely with RIA Services for operational and compliance support appropriate for their fee-only model.

The RIA-only glide path. Millennial Advisors also approaches RIA Services in September 2018. With Commonwealth for seven years, the four advisors running this firm are millennials themselves—all younger than 40, savvy with social media, ambitious, and on the fast track to success. With $370 million in AUM, the rapidly growing practice serves a diverse group of clients: rising millennials, Gen Xers, and a significant number of preretirees. The advisors at Millennial are considering moving to a fee-only model because they want to act as a true fiduciary for their clients, as well as a family office and trustee for one of their large clients.

Millennial has an initial call with RIA Services to learn more about fee-only options, and the conversation uncovers two additional objectives. First, Millennial wants compliance flexibility to increase its social media presence. Second, it sees acquisitions as part of its growth strategy—and being fee-only might create opportunities to acquire other RIA entities.

Millennial decides in September 2018 to begin the glide path to RIA-only, with a May 2019 conversion time frame in mind. The transition to this affiliation model is longer and more complex, involving client notifications and the need to update client account numbers. Again, it begins with consultative, information-gathering discussions with the RIA Services transition team.

The next step, choosing a compliance consultant, is critical because compliance responsibilities rest with Millennial as an RIA. Over the next three months, Millennial interviews firms and selects one to serve as its outsourced chief compliance officer (CCO), handling every aspect from setup and SEC registration to ongoing surveillance and oversight.

While its outsourced CCO works toward submitting SEC registration in February in time for its May conversion, Millennial and RIA Services shift to preparing the book of business for the transition, as well as hitting four critical benchmarks:

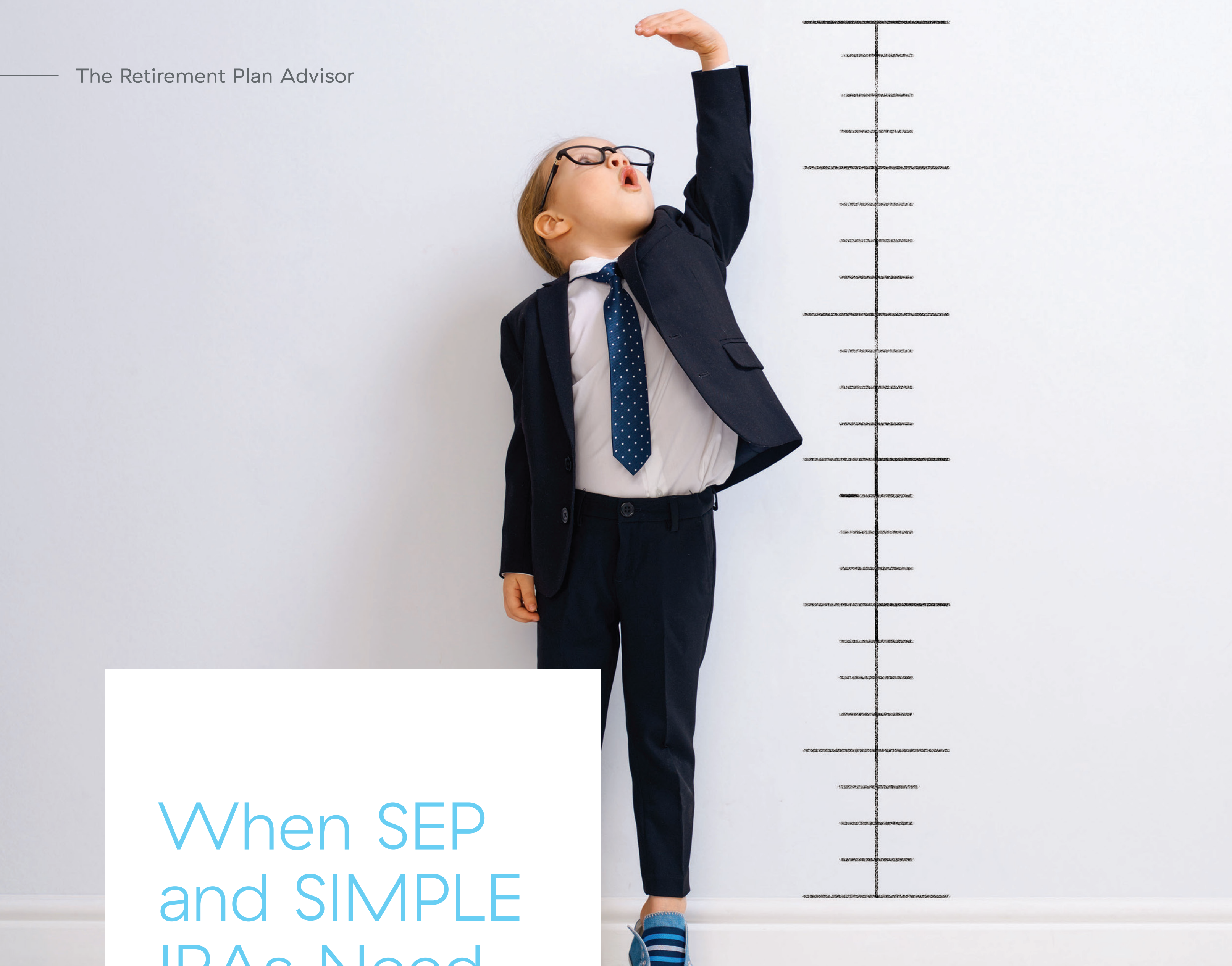
1. **Registering as an RIA:** Millennial's Form ADV is ready to submit for SEC approval in early February. After receiving approval 30 days later, Millennial is officially an RIA and its client consent letters are mailed out.
2. **Marketing:** Update all collateral, stationery, and other materials with new branding to reflect operations as a family office and RIA.
3. **AICS account conversion:** Millennial, its outsourced CCO, and RIA Services collaborate with NFS to convert client accounts via the Automated Internal Conversion System (AICS) in the week prior to conversion in May. Commonwealth ensures that everything is processed correctly, and all systems are updated.
4. **Affiliation change day:** Account conversion is complete, and Commonwealth's Licensing department processes each advisor's Form U5. Millennial is officially affiliated as RIA-only with Commonwealth.

Nearly two years later, Millennial continues to evolve and thrive as an RIA-only business. Being RIA-only allows it to be more objective and more involved in all aspects of clients' lives. The firm is also growing relationships with family members and friends of existing clients, making assets stickier. While Millennial continues to outsource its CCO function, it also taps Commonwealth's RIA-only compliance support for review of its Form ADV, client agreements, templated client agreements, and compliance policies.

Is Fee-Only Right for You?

No two businesses are the same. The best choice depends on your unique book, the kind of business you want, and where you see yourself in the future. If you're considering a fee-only glide path and want to learn more, we encourage you to contact the RIA Services team at x5663 or at *riaservices@commonwealth.com*. Our team, dedicated exclusively to supporting fee-only advisors and RIAs, can walk you through the nuances of the advisor model to help you determine the best option for you.

Erin Esposito is an advisory operations consultant, RIA services. She is available at x9461 or at eesposito@commonwealth.com.



When SEP and SIMPLE IRAs Need to Grow Up

Steven Johnian

Helping retirement plan sponsors chart the right course can yield growth benefits for you and your clients.

When choosing a retirement plan, business owners want to find the best fit for themselves, their business, and their employees. SEP and SIMPLE IRAs can be appropriate entry-level retirement plan vehicles for small businesses and sole proprietors, offering significant savings opportunities for owners and employees alike. But many businesses will outgrow the basic, rigid features these plan types offer. For them, a 401(k) plan may be a better fit—and provide more opportunities for the plan advisor.

Risks Ahead: The Coverage Gap

It's critical that small business owners are served well when it comes to their retirement plan strategy. There are more than 30 million small business owners in the U.S., and they employ nearly half the private workforce. Unfortunately, 34 percent of small business owners have nothing saved for retirement at all, according to a 2017 survey by Manta. And, a 2017 survey by Finhabits shows that just 10 percent of U.S. small businesses offer a retirement plan to employees. Yet, 78 percent of small business owners plan to sell their business to fund 60–100 percent of their retirement, according to a 2015 FPA/CNBC survey.

Why are these numbers so alarming? It's common for many small business owners to find they can't sell when they want to—or need to. Others discover the market value of their business doesn't match their expectations. The data highlights a huge risk for a business owner's retirement security. What was a big issue, even during good times, has been magnified by the pandemic. We've seen the retirement game plan derailed for many business owners who saw decreased cash flow—or even had to close their doors.

Having the *right* retirement plan can help business owners pursue their retirement goals and ensure that they aren't just counting on the sale of their business. This conversation is perhaps more relevant now than ever.

Chart the Right Course: 5 Tipping Points

As "off-the-rack" retirement plans, SEP and SIMPLE IRAs are generally easy to set up and maintain. Just as last year's shoes no longer fit your kids, however, many plan sponsors have outgrown these small plans and shouldn't make do with them any longer. In some cases, business owners don't understand their options or are fearful of the hurdles to offering a 401(k) plan. Fortunately, there are more cost-effective 401(k) solutions available now than ever, as well as many ways to ease plan sponsorship. To assist your clients, be vigilant about taking stock of their business growth and whether their current retirement plan is still the right fit. The following tipping points could signal change is needed:

1. **How much the owner would like to save annually:** This is a great starting point for a discussion. If a client wouldn't take advantage of the higher contribution limits in a 401(k), this type of plan may not be worth the added cost. For clients who want to ramp up their savings, though, considering a 401(k) makes sense. Don't lose sight of the difference between what clients say they want to save and what you recommend they save. Your recommendation should factor into the discussion.

Market Size Matters

8.6 million U.S. households have SEP, SIMPLE, and SARSEP IRAs. That's a market segment of more than 6%, according to a 2020 ICI Research Perspective report.

2. **Whether the owner has nonfamily employees:** This point is critical because a business owner with no employees may benefit from a SEP IRA or be permitted to use a Solo 401(k). In addition, having no nonfamily employees could mean the cost of making employer contributions to a plan wouldn't be a concern for a client.
3. **What the owner takes in pay:** This factor provides insight into whether a plan with higher contribution limits is warranted. It will also help you understand what a client's contributions might look like for different types of plans.
4. **The owner's sentiment toward contributing for employees:** Most retirement plans require some sort of employer contribution. Accordingly, it's good to understand the owner's feelings about making employer contributions for employees. Paternalistic employers may want to contribute more for their employees. For them, a 401(k) plan with a flexible matching and profit-sharing structure would make sense, rather than a SIMPLE IRA featuring restrictive employer contributions. Clients aiming to limit their exposure to contributing for employees may consider a SIMPLE IRA or safe harbor 401(k) to be good fits.

> Fortunately, there are more cost-effective 401(k) solutions available now than ever, as well as many ways to ease plan sponsorship.

5. **The owner's attitude toward retirement plan costs:** SEP and SIMPLE IRAs are generally low cost and easy to administer. On the other hand, 401(k) plans usually come with higher costs, along with higher contribution limits and additional plan features. Leading a discussion with costs isn't recommended. If you and a client determine that a 401(k) is the right solution based on other factors, the costs should be secondary. Nonetheless, don't leave this consideration unchecked.

Listen to What Your Clients Tell You

As with the triggers listed above, it's important to be vigilant about what you hear from your clients. Most clients won't simply say, "I need a 401(k)," but their comments about business operations should spark ideas about their retirement plan needs. Here are a few examples of what to listen for:

- If clients tell you they want to *maximize their contributions* as the business owner, you know it's time to consider an alternative to the SEP or SIMPLE IRA.
- If clients explain they want to *attract or retain top talent*, a more competitive retirement plan offering will be important.
- If clients mention *high turnover* of employees, they may need a more flexible plan design and a vesting plan. Or, they might want to allocate additional benefits for their most valued employees.
- If clients say their *business is growing*, perhaps their increasing number of employees no longer makes a SEP or SIMPLE IRA a good fit.
- If clients own *multiple businesses* that are considered controlled groups, they may need a flexible plan design and a hands-on service provider, such as a third-party administrator.

All these statements point to a need for more customization than a SEP or SIMPLE IRA plan offers. Sometimes, advisors might overlook signals like these because a 401(k) is outside their comfort zone, but not paying attention to what you hear can put you at a real disadvantage. You might miss a retirement plan enhancement opportunity that could be a better fit for the business—and more profitable for you. To find COMMunity Link® materials that can help you identify the most appropriate IRA, 401(k), or other products for your clients, go to Products > Retirement > Overview and select **Retirement Plan Resource Center**.

Real Benefits for Your Practice

There are several reasons why establishing yourself as a retirement plan advisor is a great way to reserve your seat at the business table:

1) Key business opportunities. When clients sell their business, their wealth will likely be converted from paper to liquid assets. As a trusted advisor, you may be asked to manage the new assets or, if they pass their business to heirs, you could be first in line to serve the next generation. Often, the heirs will already know you because they're likely to have been working for the business and in the retirement plan.

2) Value-add for your practice. Whether you focus on the retirement space or not, positioning yourself to advise clients on transitioning to their best-fit retirement plan is a value-add for your practice. If you're already advising clients who are business owners on their other assets, you'll be well positioned to assist if they decide to offer a retirement plan in the future. It's important to be poised to help clients take advantage of their opportunities while preventing them from looking elsewhere for advice.

3) Increased compensation. When you help an employer transition from a SIMPLE or SEP IRA to a 401(k), your compensation could go up due to increased cash flow into the retirement plan. Also, the additional advisory involvement needed to manage a 401(k) plan, compared with a SEP or SIMPLE IRA, will help you stay engaged with your clients. The plan's participants might well become clients. All in all, you'll be in a great position to uncover additional assets and offer clients a wider array of services.

4) Expanded referral network. You don't have to be a subject-matter expert (SME) to work with retirement plans. You can maintain your role as a consultative wealth manager and focus on what you specialize in by working with SMEs such as third-party administrators, CPAs, recordkeepers, and, of course, Commonwealth's Retirement Consulting team. Maintaining a network of these SMEs can ease the demands of doing business for you and your client. In addition, developing strong relationships with these centers of influence can strengthen your referral network. (Think about how many times you've received referrals from a CPA.) Continuing to expand your network could certainly support your overall growth strategy. Due to your increased involvement with clients, you may find opportunities to meet with plan participants in group or one-on-one settings. This could generate the potential for greater relationship building with key decision-makers.

Incorporating retirement plans into your service model is a great way not only to elevate your practice but also to help those you serve reach their goals for retirement security. As a plan sponsor's trusted retirement advisor, you'll enjoy opportunities to solidify your relationships with business owners and employees alike. Ultimately, adding the retirement plan space can have a great impact on your practice.

Steven Johnian is supervisor, retirement consulting services. He is available at x7033 or at sjohnian@commonwealth.com.

Where's the Compliance Risk? Tips for Running a More Bulletproof Practice

David Moon

There is an interesting duality to my role within Compliance at Commonwealth. I deal with regulations and policies, which are predictable, but I also see client complaints and regulatory audits that are anything but. The past year opened our eyes to the possibility of certain risks that previously were not in our realm of possibility. It also brought us Regulation Best Interest (Reg BI), whose full implications and risks we don't yet fully understand. The thing about risk in a dynamic, regulated industry that deals with deeply emotional matters like financial security is that it's always present.

While risk can be unpredictable, there are steps you can take to help identify, mitigate, and even avoid it, so you can continue running your business in a safe, compliant manner.

Make Consistent Recommendations

The essence of Reg BI is that you must act in your client's best interest, regardless of your affiliation. The rule and your responsibilities to adhere to it will affect any and all recommendations you make to new and existing clients. Take the time to build the components of Reg BI into the roots of your practice so you remain in compliance with industry regulations.

Be prepared for questions. Let's look specifically at Form CRS, which is the component of Reg BI that will affect the recommendations you make. The form prompts clients and prospects to ask some of the following questions:

- Given my financial situation, should I choose an investment advisory service? Should I choose a brokerage service? Should I choose both types of services? Why or why not?
- Help me understand how these fees and costs might affect my investments. If I give you $10,000 to invest, how much will go to fees and costs, and how much will be invested for me?
- How might your conflicts of interest affect me, and how will you address them?

Having solid answers is key to beginning and maintaining a strong client relationship, as well as remaining compliant with Reg BI.

> Make documentation a routine habit.

Be aware of your obligations. Especially notable about Reg BI is the Care Obligation, which requires advisors and registered representatives to consider "reasonable available alternatives," meaning that you must make your clients aware, for example, of the difference in cost between advisory accounts and brokerage accounts.

Be sure to thoroughly document your decision process and your conversations with your clients to prove that you are making the best choices for their particular situation. Show that you've taken the time to understand their wants and needs and to explain each topic. This open and honest communication also serves to build trust and strengthen your relationship.

Be proactive about communications. Because Form CRS will be delivered so frequently, take the time to create a set of templates now—one for delivery to prospects and one for existing clients. This will save you countless hours down the road. Three templates are already available in the Four-Corner Marketing tool on COMMunity Link® for your convenience:

- Preparing for a Meeting
- Rollover Discussion
- Annual Review Meeting

Establish a Repeatable Portfolio Management Process

Commonwealth's Preferred Portfolio Services® (PPS) Custom program is a great vehicle for helping your clients achieve their investment goals while also eliminating many conflicts of interest associated with commission-based products. Because it puts responsibility for portfolio management solely on you as the advisor, you need to ensure that your process for ongoing monitoring is sound.

Be on the lookout for risks and appropriateness. PPS Custom may not always be the best recommendation for a particular client. Your process should include the following compliance considerations (i.e., risks), and your findings—and recommendations—should be in writing:

- **Cost comparisons of the different options available:** Document a clearly defined reason for your recommendation and ensure that it remains in alignment with the client's financial objectives and risk tolerance over time.
- **Concentrated positions:** PPS Custom is designed for active and ongoing management, which can't take place among limited positions.
- **Types of trades:** If the majority of trading is done on an unsolicited basis, with clients requesting the trades, PPS Custom may not be appropriate.
- **Conversions from direct accounts or brokerage accounts to PPS Custom:** If the client remains in the same or similar positions as they held in the commission-based account, how was the conversion in the client's best interest?
- **Rollovers:** If the client remains in the same or similar positions as they held in their 401(k) or retirement account, how was the conversion in the client's best interest?

Document (and Document Some More)

Good documentation will show what you've reviewed, how you reviewed it, the reasons behind your recommendations (including recommendations for no changes), and what the plan is going forward.

Be consistent. Make documentation a routine habit. Create a follow-up template that you send to clients after each meeting to review and confirm what you discussed. This will help clients feel both heard and understood. Plus, it can serve as powerful evidence during any regulatory inquiry.

Assess Yourself to Protect Yourself

Here are three reports, available at My Practice > Reports > All Reports on COMMunity Link, you can pull regularly to spot-check for compliance risks:

- **Trade Activity report:** Quickly spot accounts that have not traded in the past 12 months.
- **Asset Allocation report:** Identify accounts or households whose asset allocations might be misaligned based on their investment objectives. For the Grouping filter, select either "Account" or "Household," then "Broad Asset Mix" to get a snapshot of cash, equity, and income allocations.
- **Account Register report:** Unlike the previous two reports, this one offers many filtering configurations you can experiment with. You can easily view cash balances, whether the account is in a model, what the advisory objectives are, and benchmarks.

Prove Your Worth

Ultimately, your documentation standards should be such that you feel comfortable demonstrating to a client's lawyer how you are acting in your client's best interest. But most important, your documentation should show that you are worthy of the trust and confidence your client has in your role as their advisor.

David Moon is a senior compliance advisor on the Branch Audit team. He is available at x7170 or at dmoon@commonwealth.com.

Best Practices to Avoid Common Cyberthreats

Nas Benmederbel

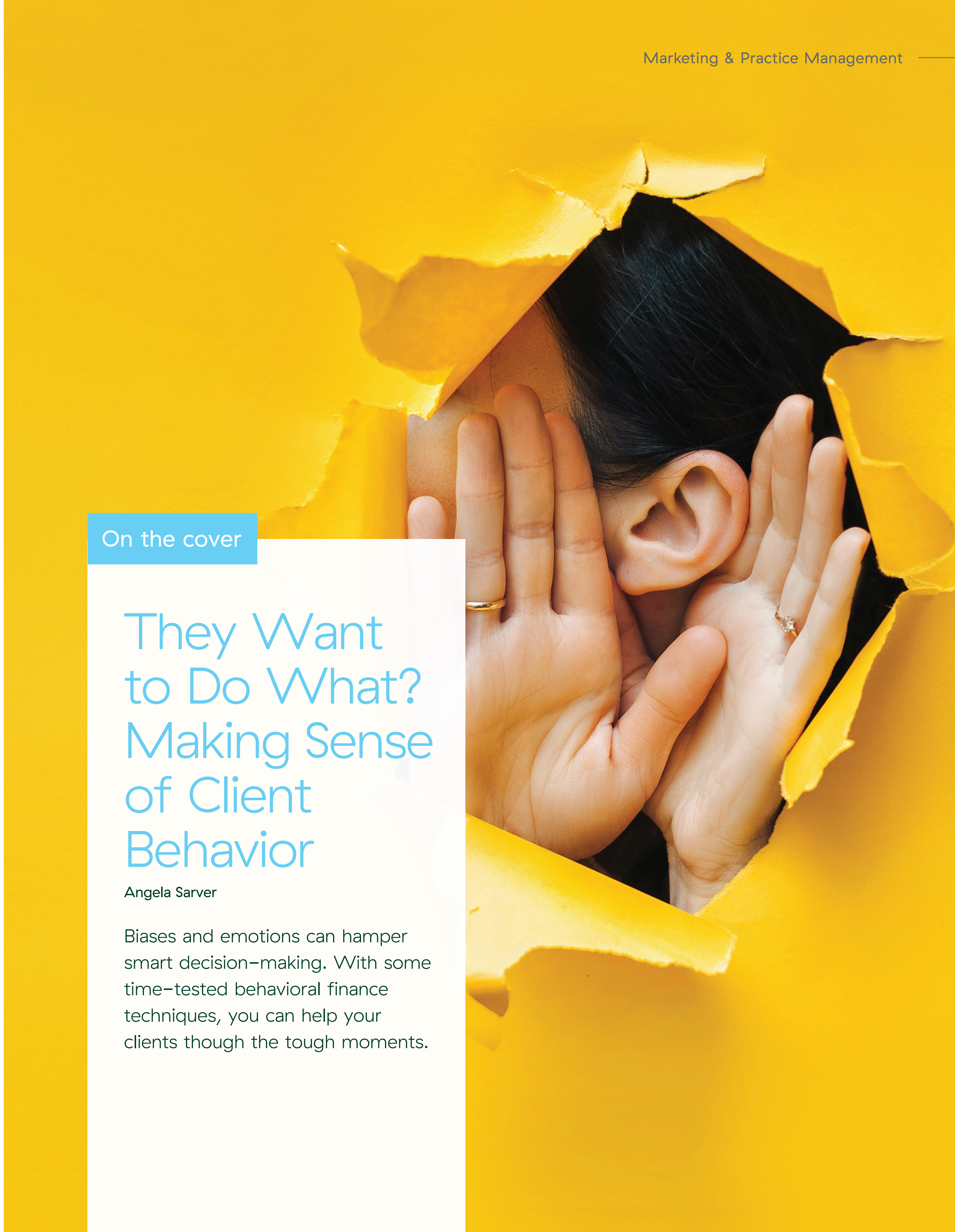
Cyberthreats have become commonplace—and attacks are on the rise during the pandemic. With so many working remotely, cybercriminals have more opportunities to identify and exploit vulnerabilities. These practical tactics can help you protect your practice from common information security threats—and send hackers packing.

	Do	Don't
Mobile Scams: Say Goodbye to Phone-y Calls	✓ Verify the phone number by calling the institution/firm directly ✓ Use any phone scam identification services offered by your wireless provider	✗ Open links in text messages ✗ Provide personal or sensitive information or passwords to incoming callers (only give info if *you* make contact using an official number)
Email Phishing: Avoid the Bait	✓ Delete the email ✓ Verify the sender by directly calling the number from the company's official website ✓ Report suspicious emails to Information Security	✗ Give out passwords or personal information until you validate the request ✗ Click suspicious links or open attachments ✗ Forward or respond
Malware Infections: Stay Immune!	✓ Update your browser and operating system on work and personal devices before using the internet ✓ Use regular (not privileged or local administrator) accounts for daily operations	✗ Open attachments without verifying ✗ Download software from untrusted sources ✗ Use USB removable drives
What's the Password? That's Confidential	✓ Use unique, complex passwords (10–12 characters, using a combination of uppercase and lowercase letters, numbers, and symbols) ✓ Update regularly, at least every 90 days ✓ Try a passphrase that's easy to remember but hard to guess (e.g., I am Secure Today > #IamS3cure!TOday) ✓ Consider using a password manager	✗ Reuse old passwords ✗ Use the same password for multiple accounts ✗ Use the "save password" feature

Play It Safe!

Keep in mind a few general online safety practices, too, such as keeping your software and applications up to date and avoiding storing payment information on your browser. To learn more, visit My Practice > Information Security > Overview on COMMunity Link® and explore the links under Best Practices.

Nas Benmederbel is director of security engineering on the Information Security team. He is available at x4226 or at nbenmederbel@commonwealth.com.



On the cover

They Want to Do What? Making Sense of Client Behavior

Angela Sarver

Biases and emotions can hamper smart decision-making. With some time-tested behavioral finance techniques, you can help your clients though the tough moments.

A year ago, when COVID-19 was beginning to rage in the U.S. and the markets were experiencing the kind of volatility we hadn't seen in some time, an advisor told me about an interesting development. While many of his clients weren't worried about the shift in the markets, some were determined to undermine their long-term plans by converting most everything to cash. He thought to himself, "You want to do what, now?"

Unusual times tend to widen the gap in understanding between advisors and client actions. Questionable requests or rash thinking can derail plans. To get back on track, behavioral finance techniques can help you better understand where your clients are coming from and steer them toward their goals.

The Challenge: Keeping Connected

Of the many unique challenges of 2020, a major one was keeping connected with clients when in-person meetings weren't possible. Advisors weren't daunted, however. They got creative. Along with getting accustomed to Zoom meetings, they found new ways to stay in contact. One advisor drove by clients' homes so they could wave to each other or chat by the car for a few brief minutes, while others brought clients small gifts to let them know they were top of mind. For most advisors, checking in more frequently with clients is especially important during periods of market volatility. It keeps the lines of communication open and provides insight into how clients are feeling.

If anything, 2020 affirmed the importance of nurturing and strengthening the client relationship. You can tweak your service model or strive to provide "wow" client experiences. But strengthening the relationship requires a greater understanding of why clients make the decisions they do.

Knowing Clients' Risk Thresholds and Biases

Understanding your client's risk tolerance is a critical factor in making the right investment choices when constructing their portfolio. With the right asset allocation, you can help the client achieve financial objectives over the long term while staying the course, despite outside influences. This understanding also provides an opportunity for addressing behavioral biases, or irrational beliefs, that can affect how clients process information and make decisions (e.g., loss aversion).

Our Risk Tolerance Questionnaire (available on COMMunity Link® at Financial Planning & Research > Financial Planning Playbook > Overview > Client Worksheets, under Getting to Know Your Clients) is one way to understand a client's appetite for risk. In most cases, however, clients complete the document in a neutral setting when they are calm and have no pressing worries. Contrast this state to the emotional state they experience when the market is volatile.

While the questionnaire can provide insight, it's only a first step in exploring how clients really feel about risk. Risk tolerance tools can provide additional insight, as can powerful questions that can be asked to truly understand what makes clients tick. These include:

- What is the worst thing that can happen when considering your investments?
- What concerns you the most about your financial future?
- How would you feel if your investments lost money?
- What are your biggest money worries, and how do you hope I can solve them with you?
- What is most important to you when considering your future?

Advisors who accurately recognize the risk profiles of their clients during the portfolio construction process will be more prepared to deal with biases as they arise. Of course, finding the balance between adhering to clients' comfort level with risk preferences—versus their ability to take risk—is a significant challenge.

Paying Attention to Hints

Clients drop hints when things aren't quite right, and through active listening, we can pick up on them. For example, clients may use emotional words like "I'm scared" or "I'm nervous about" or "I'm worried." They may also give you insight into their actions by saying things like "I'm checking my accounts every day, and the fluctuation upsets me," or "I'm not paying attention to the news anymore." By purposefully listening for such statements, you gain an opportunity to dig deeper, to better understand what the client is really experiencing.

Sometimes silence is deafening. If you haven't heard from some clients in a while or a client isn't saying a lot during a review meeting, that's a signal something may be going on. In those cases, think about how you can support them while helping them understand the biases that may be influencing their feelings and decisions.

There are overarching behavioral biases: *emotional* biases, which involve taking action based on our feelings rather than facts or letting emotion cloud our judgment, and *cognitive* biases, which are errors in our thinking that occur while processing or interpreting information. Research from Cerulli Associates confirmed that two of the prominent types of behavioral biases among clients are recency bias (35 percent of advisors listed it as a top five behavioral bias) and loss aversion (26 percent).

1) Recency bias. Have you ever bought a white car and shortly thereafter noticed that almost every car on the road is white? This is recency bias, a tendency to give more weight or importance to recent events than earlier events. Statistically, there weren't more white cars on the road—you just had a heightened awareness of them as car color was a recent focus of yours. A similar effect could occur after seeing this headline: "Bitcoin nears $50,000!" Clients who see that may miss the rest of the story that states bitcoin can be a good short-term investment, but it may not fit an investor's long-term goals.

Recency bias can influence clients during periods of market volatility. They become focused on the downward movement and want to make changes to their portfolio. Here's where you can help clients understand that market movement isn't unusual and that, historically, over time, the market continues an upward momentum. You can show them the trends in their own portfolio, reinforcing the focus on the long term. You can explain that yesterday's truth is not tomorrow's truth and that no pattern continues forever. And you can address their concerns head-on by asking questions like, "What worries you the most about the current market conditions?"

2) Loss aversion. This bias occurs when clients experience more sensitivity to losses than gains. Studies show that people choose to take a risk only when the potential gain is two times greater than the expected loss. When the action involves money or anything perceived as an asset, avoiding loss is a far more powerful instinct than pursuing gains. This explains why clients may not want to sell loss-making investments, even though it will lead to further losses. Sometimes understanding this concept can help clients reduce the impact of loss aversion on their ability to build wealth.

Advisors are not immune from experiencing biases, either, so consider your own feelings to determine if something is influencing your decisions. For example, if you have a bias toward loss aversion, you might be more concerned about diversification, savings patterns, insurance coverage, and investment horizon.

Strategies for Keeping Clients Informed

Understanding why clients act how they do goes a long way toward meeting them where they are and customizing your approach. These best practices, shared by advisors, can take the relationship even further.

Focus on the long term. Helping clients take a long-term view can combat emotions and biases, an especially helpful skill during periods of volatility. Remind clients of their investment goals, and ensure that they adhere to a sensible financial plan as a way to help them reduce emotional reactions and avoid making poor investment decisions.

> Advisors are not immune from experiencing biases, either, so consider your own feelings to determine if something is influencing your decisions.

Show (don't tell) clients when they don't understand something. Taking your word that "everything will be okay" may not be enough for clients panicking over bad news. Charts, graphs, and visual illustrations can better demonstrate that this time isn't different after all. In this way, concepts that are vague and difficult to grasp become tangible and easier to internalize.

Put it in writing. When crafting an investment policy statement or conducting review meetings, be specific about what the plan will be in anticipation of future situations. You can also outline the behaviors the client is likely to experience. In many cases, acknowledging a behavioral bias ahead of time is enough to diminish its effect. Additionally, having a written record will create an accountability mechanism for the client. It sounds simple, but a client will have less skepticism about your advice if you set expectations early and can show you anticipated both the possible investment situation and the behavior it might cause.

Focus on the data. People relate better to stories and are all too willing to believe and concoct narratives to support their actions. Present information that has a data-driven perspective and process behind it.

Actively seek out contrary data and conclusions. Our tendency is to look for and consider only those views that correspond with ours. If we want to be able to see things differently, we need to seek out sources that show another perspective. When you present an opposing view, let clients know you take them seriously but that you researched the matter and found a different viewpoint that would be beneficial to discuss.

Avoid the noise. Given the sheer number of things competing for our clients' attention, they may struggle with determining what they should listen to and what isn't important. I know several advisors who have recommended that clients turn off CNN and other news outlets. Explain that eliminating distractions that are unlikely to provide value can improve the likelihood of success. So, you may want to suggest not only limiting daily news consumption but not checking account balances every day, too.

Personalize the client experience. Find specific ways to communicate based on a client's risk preferences and behavioral biases. This approach demonstrates that you understand where they're coming from and provides a personal touch that cannot be duplicated by an algorithm. For example, advisors are developing new and creative ways of crafting customized experiences, including virtual client events like wine tastings and following a new recipe together.

The Secret Sauce

Your clients work with you for several reasons, and many recognize that a goal without a plan is just a wish. They're relying on their advisor to make that wish come true. While you may not be able to implement every strategy included here, you can bring awareness to your clients' biases so they can better understand how emotions influence money matters.

These techniques can help you build trust, improve investment decisions, and manage expectations and outcomes. Many advisors already use them, whether consciously or subconsciously, knowing that when you understand the psychological, emotional, cultural, and social factors that affect clients' decisions, you can guide them toward making more informed choices. This is something a robo or self-service investment platform cannot do. It's your secret sauce.

Angela Sarver is a senior practice management consultant. She is available at x9873 or at asarver@commonwealth.com.

Professionalize Your P&L and Grow Value

Dina Sonenshein and Kenton Shirk

Advisors frequently come to Practice Management looking for help with how to grow the value of their business. Given the historic industry focus on the top line, it's no surprise that their initial questions are often centered around production. But that misses a critical factor. Although we work in an industry where informal structures are commonplace—whether handshake deals or eat-what-you-kill models—to position your firm for growth, a key first step is to gain a better understanding of the financials of your firm, especially if you're building an integrated ensemble or large-scale enterprise.

> When all revenue and expenses flow through the organization in their entirety, you gain a clear, holistic picture of performance.

How Firms Derive Value

It may seem counterintuitive, but the value drivers for a small book of business are different from those of larger firms. In the former, value is derived from the future cash flow potential of the underlying client base and takes into consideration factors such as demographics, revenue mix, and asset concentration. A buyer of a book of business typically focuses on client assets, for example, so the cost structure for the acquired business is less relevant in a valuation.

With an integrated ensemble or large-scale enterprise, value is derived from the profitability and sustainability of the business itself. When you purchase equity in a firm, you're not just acquiring a group of households; you're buying into the overall strength of the organization. Factors such as scale and efficiency, human capital, infrastructure, operations, and brand become critical considerations to driving value. And, perhaps even more important, you are purchasing the right to your share of the operating profit generated by that firm.

Focus on the Financials

By adopting professional accounting practices for all advisors collectively affiliated with your firm, you can centralize your financial management. When all revenue and expenses flow through the organization in their entirety, you gain a clear, holistic picture of performance.

Professionalizing your profit and loss statement (P&L) drives value in three important ways:

1) It shifts the focus from top- to bottom-line performance. An increase in production doesn't necessarily correlate with an increase in profitability, so you'll need to create a standardized way of measuring whether your growth is increasing or eroding your bottom line. Once you shift focus, it's essential that the interests of everyone in the organization are aligned around profitability because you want to create a system where everyone does well only when the firm does well. That way you bind everyone to the success of the firm instead of to the success of an individual.

2) You will have a clearer picture of the drivers of that success. Once you have a complete view of your firm's finances, you can identify and track the key performance metrics of your business. Tracking a metric such as overhead expense ratio, for example, can tell you whether you're managing the operating costs of running your business more or less efficiently year-over-year, while profit per client indicates the degree to which you're able to scale service delivery in relation to your average client.

3) It will shift your mindset to thinking like an entrepreneur. Many advisors play two different roles in their organizations: professional advisor and business owner. As you start to build a multiadvisor organization that can survive your eventual departure, you need to separate those two identities so the business can continue to thrive and grow without being overly dependent on you. What's more, it helps younger advisors joining the business because it encourages the strategic, venturesome perspective necessary to succeed at the partner level. Many advisors struggle with the question of who will take over when they step back. Shifting your mindset can help you discern who will be the right fit for all aspects of the role.

Actionable Steps to Professionalize Your P&L

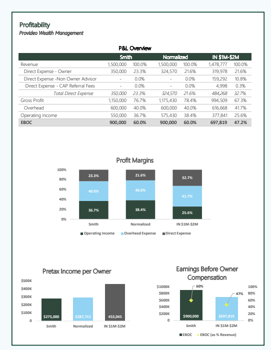
When you're ready to move forward on the path to professionalizing your P&L, there are several steps you can take:

1. As mentioned earlier, ensure that all revenue and expenses flow through the firm in a centralized manner. This is the only way to get a complete picture of the financial position of the business, but as a firm moves from silos to this centralized structure, it can also mean a radical shift in company organization and culture.
2. Align your P&L with the *InvestmentNews* biennial Pricing & Profitability Study, which leverages a standardized accounting method used by many advisors. Matching your chart of accounts to the specific overhead categories used in the report provides a high-level framework that concisely structures your data. Adopting this format for your financials can have several important implications:
   - It streamlines the process of benchmarking your financial data, which helps you compare your performance with that of your peers.
   - It more accurately captures revenue and expenses. Advisors often deduct pass-through expenses by Commonwealth, such as licensing fees and insurance, from their revenue. But these are business expenses that should instead be deducted from your overhead as operating costs to ensure that you're not undercounting revenue in relation to benchmarks.
   - It separates direct expense, or the compensation paid to owner and non-owner financial advisors for the delivery of financial advice. Essentially, direct expense functions as the cost of goods sold in an advisory practice because the input to create your product (financial advice) is your advisors' time.
3. Create a structure that sets defined compensation for owner and non-owner financial advisors. By paying fixed salaries and/or variable compensation to owner and non-owner advisors for the role of providing financial advice to clients—exclusive of profit distributions to owners—you're able to differentiate the cost of providing advice to clients from the return on investment of being an owner of the business. While all advisors would receive salary and variable compensation for their role as a professional advisor, owners would receive profit distributions as well.
4. Assign someone to actively monitor the financial performance of your firm. You don't need to hire a chief financial officer, but someone should be responsible for setting financial goals based on P&L metrics and tracking them over time. By tracking average revenue per household, for example, you can monitor whether your firm is adding larger or smaller households, while revenue per total headcount will give you insight into how productive your advisors and staff are. We recommend benchmarking your data annually with Practice Management, but the key is to track your performance over time. While comparing your performance with that of your peers is always helpful, seeing changes in your business year-over-year is even more important because you can identify trends.

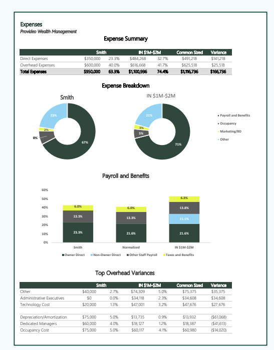
Snapshot of 10-Point Financial Check-Up

The 10-Point Financial Check-Up analyzes critical levers that affect your firm's profitability, measures your critical financial metrics, and compares them with peer benchmarks. Contact Practice Management to request a personalized report and get help analyzing the results.

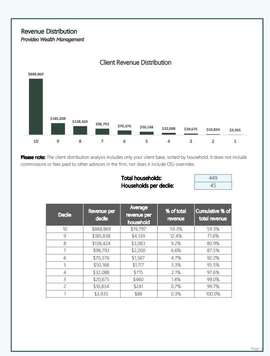
Profitability



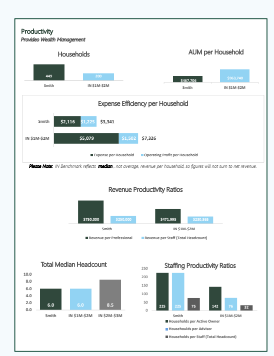
Expenses



Revenue Distribution



Productivity



Create a Lasting Legacy for Your Firm

As firms focus on growth, an increasing number are pursuing equity structures for ownership. Although not ideal for all firms, especially if the owners prefer a production-based approach to compensation and ownership, this structure binds owners to the collective success of the firm versus their individual sleeve. In addition, it creates a structured path to internal succession through continuous purchasing and selling of equity shares rather than individual client relationships. The goal is to create a long-term path to ownership for those whose work drives the firm's growth and success by providing an opportunity to buy into the firm in small increments over an extended period.

A professionalized P&L is necessary for an equity structure to work because the value of equity is not only the value of the shares at the point of sale, but also receipt of profit distributions based on proportionate ownership. That is, if you own 10 percent of the business, you'd be entitled to 10 percent of the profit of that business. Profit distributions play a key role in equity structures because they create value in holding ownership and can be leveraged by next-gen advisors to finance their equity acquisitions. To make that possible, profit generally needs to be approximately 20–25 percent of net revenue so equity holds meaningful value and those next-gen advisors can garner adequate profit distributions to afford share acquisition. And, for all the puzzle pieces to fit, the compensation and profit distributions must be formalized and consistent.

Let Practice Management Help

For advisors who want to grow, especially those who want to create firms that will outlast them and their partners, professionalizing your P&L is an essential first step. Practice Management can help you set up the systems for the firm you want to become, not just for the state of your business right now. Our 10-Point Financial Check-Up is designed to reformat your firm's P&L and highlights essential metrics to measure profitability and productivity, which will provide insight into your financial health. (More information is available on the 10-Point Financial Check-Up page on COMMunity Link® at My Practice > Practice Management > Business Planning and Leadership.) We are happy to work with you as you take this critical first step in positioning your firm for continued, profitable growth.

Dina Sonenshein is a practice management consultant. She is available at x9437 or at dsonenshein@commonwealth.com.

Kenton Shirk is director, practice management. He is available at x4285 or at kshirk@commonwealth.com.

Investment Allocation: A Look Behind the Curtain

Chris Shwartz

A client calls the office in a panic. He's invested in a company facing a scandal, and its stock is dropping. Now what?

Step one is to rein in the anxiety and provide clarity. Although a media firestorm may affect the company's market value, it's likely the diverse portfolio your firm has created means these investments are just a piece of the pie. But to help articulate how clients' investments are allocated (and ease their worries), it's important to understand how these investments are evaluated, composed, and grouped. With that in mind, let's take a peek behind the investment allocation curtain.

> With the investment universe being so large, Commonwealth established a relationship with Morningstar for investment classifications and attributes, which are used in our different applications.

Where Does the Data Come From?

Without getting too technical, investments *currently and previously held* by clients are stored in our investment database, which feeds into many applications in Client360°,® Practice360°,® and Investor360°.® With the investment universe being so large, Commonwealth established a relationship with Morningstar for investment classifications and attributes, which are used in our different applications.

Next, let's view investment allocation through the investment composition lens. We will use the PPS Select Passive Primarily Equity with Alternative strategy. (To learn more about this strategy, see the Models with Alternatives page on COMMunity Link,® available at Products > Fee-Based Programs > PPS Select.)

Investment Composition

Where do you begin with a question like this: "What are my mutual funds invested in?" The simple answer is asset class—a grouping of similar types of investments that provide a broad perspective of investment composition.

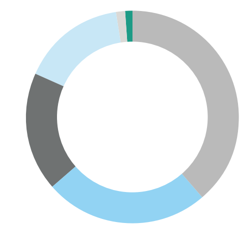
Say you invested in apples, bananas, broccoli, and spinach; your general asset classes would be fruits and vegetables. Like fruits and vegetables, investment asset classes are broad groupings of investments, such as equity, fixed income, and cash. Depending on the underlying holdings, the investment could have one or multiple asset classes.

Within the 360° Suite, asset class is displayed using the asset class (primary) and asset class x-ray methods.

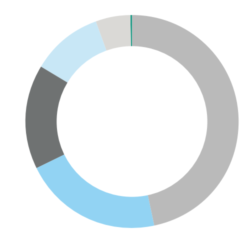
Asset class (primary). This is the primary asset class of an investment, with a single asset class attributed. There are seven asset class groupings: domestic equity, international equity, balanced, alternative, domestic bond, international bond, and cash and equivalents. The asset class is derived from the asset category of the investment (more on that later). For example, an investment in Treasury bills (i.e., short-term government investments) would have an asset class of domestic bond. When using this methodology, each investment has a single primary asset class derived from its asset category.

What about investments with multiple asset classes like target-date mutual funds, which are invested in equities and bonds? These multi-asset class investments are attributed to the balanced asset class in the asset class (primary) method. If we want to take the analysis further and attribute a percentage value for each asset class within an investment, the asset class x-ray method would be used.

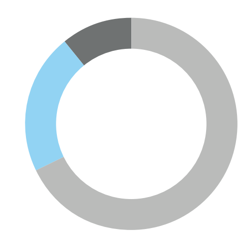
Figure 1. Asset Class Allocation Methodologies



Asset Class (Primary)	(%)
Domestic Equity	38.83
Alternative	24.98
Domestic Bond	17.94
Domestic Equity	15.94
Cash and Equivalents	1.32
International Bond	0.99
Total	100%



Asset Class (X-Ray)	(%)
Domestic Equity	46.89
International Equity	21.13
Domestic Bond	15.84
Cash and Equivalents	10.82
International Bond	5.42
Other	(0.10)
Total	100%



Broad Asset Mix	(%)
Equities	67.92
Fixed Income	21.26
Cash Equivalents	10.82
Total	100%

Asset class x-ray. This methodology breaks down the investment's underlying holdings and attributes a percentage to each of six asset classes: domestic equity, international equity, domestic bond, international bond, cash and equivalents, and other. Revisiting the target-date fund example, the asset classes would be 70 percent domestic equity and 30 percent domestic bond. Rather than attributing the asset class based on the investment's primary asset class, we are provided with a more compressive percentage breakdown of each asset class attributed to the investment.

Using the same percentage methodology, broad asset mix reduces the allocation groups to equities, fixed income, and cash equivalents. This simplification will provide the most basic understanding of asset classes. (See Figure 1 for a graphical comparison of the different methodologies.)

Asset category. For a more granular assessment, asset category comes into play. Like asset class (primary), there is a single asset category based on the underlying investment holdings, and it reflects the investment objective. There are 122 asset categories (e.g., large-cap growth, short-term bond, and direct real estate). There is also a broader variation with broad asset category (18 asset categories).

Investment Type

"What type of investments do I own? Do I own mutual funds or ETFs?" To answer these questions, you must be familiar with asset type—a broad grouping of similar investment structures (also known as the investment vehicle). There are two grouping methods: asset type and asset subtype. The difference between the two? Specificity.

Asset type. There are nine asset types: alternative investment, annuity, cash, cash and equivalents, equity, ETF, fixed income, mutual fund, and closed-end mutual funds. Within these asset types, there are many more specific investments structures with similar characteristics. To further break them down, we use asset subtype.

Asset subtype. There are 59 subtypes. Depending on the structure, there may be varying tax, trading, and administrative aspects for asset subtypes that aren't distinguishable at the asset-type level.

Apply Your Knowledge

There are 13 investment allocation reports in Client360°, not to mention the various charts and figures displayed in Practice360° and Investor360°. By elevating your familiarity with investment allocation, you'll be able to confidently share these reports with clients and communicate effectively regarding their diverse portfolios.

If you're interested in learning more about investment allocation and 360° Suite enhancements, check out the presentation videos and live session replay on the 2020 Staff Road Show conference website.

Chris Schwartz is a performance reporting analyst in the Portfolio Reports and Data Services department. He is available at x4370 or at cschwartz@commonwealth.com.

The Power of Ally Love:

Tips for Leading an Intentional Life

Meghan Powell

What if there were no such thing as work/life balance? No scale featuring career goals on one side and personal lives on the other? What if instead of always looking for something better, we started delighting in less and redefining success? Would we find deeper happiness? Ally Love thinks so.

In celebration of Women's History Month and our ongoing commitment to women's initiatives, the Women of Commonwealth community hosted a conversation with the multihyphenate Ally Love. In this wide-ranging talk with Jessica Fougere, vice president, conferences, events, and community engagement, Love shared tips on leading an intentional life with nearly 200 of our women advisors and staff. After the conversation, attendees connected in small groups to exchange key takeaways with their peers.

The multifaceted Ally Love

Be Transparent

As a Peloton instructor, in-arena host of the Brooklyn Nets, founder and CEO of Love Squad, an Adidas global ambassador, and model, Love is no stranger to a full plate. In her experience, trying to separate the different versions of herself is unrealistic. "I want to bring who I am with me everywhere," she said—arguing that it's powerful to share all the facets of our lives and embrace the harmonious dance between them.

So, if you have children, you'll naturally be able to lean more into work when they're in school versus when they're home for the summer (or during a global pandemic). According to Love, it's okay to be transparent about who you are and to set necessary boundaries.

> It's powerful to share all the facets of our lives and embrace the harmonious dance between them.

Find Joy in Who You Are

Love uses her platform to celebrate diversity and wellness through conversation and sweat and urged attendees to take care of themselves as a whole: the physical, mental, and spiritual. She noted creating new habits can start with something as small as a five-minute break—whether for deep breathing, playing brain games, or sitting quietly before your day begins—and finding joy in who you are.

Save the Date: 2021 Virtual Summit for Women Advisors

For more inspiring content targeted to the Women of Commonwealth community, be sure to save the date for our third annual Summit for Women Advisors, which will take place virtually June 23–24, 2021. Additional details, including information on how to register, will be emailed in late April.

Meghan Powell is a communications and content strategist on the Conferences, Events, and Community Engagement team. She is available at x7158 or at mpowell@commonwealth.com.

A Year of Caring

Miriam Schwartz

You might expect a year-end recap to come at the end of December or the beginning of January, so this giving back recap may seem to come at an unusual time. But as we pass the one-year mark of the COVID-19 pandemic, which brought so much of our day-to-day to a halt, we have an opportunity to examine how the Commonwealth community—made up of advisors, support staff, and our home office employees—has continued to give back generously. Individually and under the umbrella of Commonwealth Cares, we continue seeking to make a profound difference in our world.

Glimmers of Hope

We gave out more than **$460,000 in grants,** with the largest going to food banks on both coasts.

As always, Commonwealth Cares' mission remains the same: *We are a 501(c)(3) charity created to maximize the impact of our many and varied efforts to give back to the communities in which we work, live, and visit.* Our grants are focused on relief of human suffering, disaster or poverty relief, and sustaining the planet's resources.

In the past year under COVID-19, nothing was more important than food security for our communities and getting food to those in the greatest need. That's why our largest grants went to food banks on both coasts, with thousands of meals donated through the Greater Boston Food Bank and the San Diego Foundation's COVID-19 Community Response Fund. In a testament to the power and commitment of our Commonwealth family, this has been our largest giving year ever, with $460,000 in grants given—despite 90 percent of our 2020 activities being cancelled due to the pandemic.

While we were able to give more as a foundation, truthfully, we miss doing it together with our colleagues on both coasts and with you, our advisors, at giving back events at our conferences. We've heard you and we know you miss these events, too. We will resume a more robust schedule of events (we typically hold 50–60 per year) as safety allows. In the meantime, we continue to offer virtual ways to give back. Most recently, our February fitness challenge honored American Heart Month, raising $2,000 for the American Heart Association.

This challenging year has shown glimmers of hope that have carried us through as we redouble our focus on Commonwealth Cares' second decade. Do you have giving back efforts you'd like to share with us? Upload your photos and stories to us by going to the Community tab on COMMunity Link® and clicking on "See our community in action" under Giving Back. We just may share them on social media and with your fellow advisors.

Miriam Schwartz is a senior marketing writer. She is available at x9543 or at mschwartz@commonwealth.com.

A Welcome to New Advisors

Andrew Daniels

Please welcome the following advisors who have recently joined us.

Name and Former Firm

Donald Bucchi, Yardley, PA
Avantax Investment Services

Richard Carlquist, San Diego, CA
Cetera Advisor Networks

Austin Collins, Bellevue, WA
Ameriprise

Andrew Davis, Fitchburg, WI
Ameriprise

Justin Emmert, Prince Frederick, MD
M&T Bank

Steve Fagan, Fitchburg, WI
Ameriprise

Asher Lieblich, Brooklyn, NY
Avantax Investment Services

David Lieblich, Pomona, NY
Avantax Investment Services

Malka Lieblich, Brooklyn, NY
Avantax Investment Services

John C. Manocchio, Truckee, CA
Waddell

John N. Manocchio, Truckee, CA
Waddell

Mary McCafferty, Depew, NY
Lincoln Financial Advisors

Jonathan Miller, Lockport, NY
Geneos

Jordan Moore, Dallas, TX
Edward Jones

Shawn Quam-Schulz, Roscoe, IL
Ameriprise

David Rucki, Fort Washington, PA
Edward Jones

Bernadette Smith, Pittsburgh, PA
N/A

Rob Surprenant, Warwick, RI
Santander

Marc Wagner, Yardley, PA
Avantax Investment Services

Andrew Daniels is the managing principal of business development. He is available at x9183 or at adaniels@commonwealth.com.

There's More Online!

Looking for additional ideas and strategies for your business? Check out our online exclusives in the *eCBR*. (From the homepage of COMMunity Link®, click on **more *eCBR*** in the bottom right corner of the *eCBR* widget.)

New This Month!

Wealth Planning

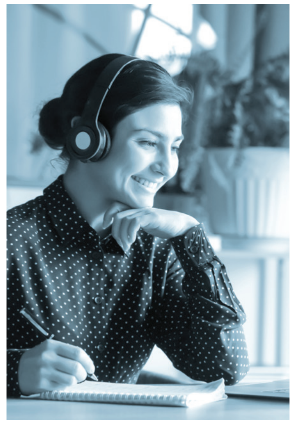
Are There Cracks in Your Clients' Credit?
Aric Jacobson, JD, LLM

When it comes to repairing, refreshing, and upgrading their credit to ensure financial wellness and a more secure financial future, it's likely many clients could use your professional guidance. By helping them perform a credit score checkup—from knowing what factors affect their score to educating them on steps to take to repair their credit—you can get clients back on the road to financial well-being.

The Retirement Plan Advisor

The Auto-Features Advantage for Plan Participants and Sponsors
Dan Collins

Retirement plan automatic features are an effective way to boost savings for plan participants—and there are real advantages for plan sponsors as well. But how can you help your plan sponsor clients pull the right levers and take full advantage of the benefits of auto features? Learn three key things you should be doing, plus some valuable talking points to get the auto-features conversation started.



Cybersecurity & Enterprise Risk

Working with Third-Party Vendors: Reducing the Risk
Andrew Boncoddo

As a business owner who has access to, maintains, and stores your clients' sensitive information, the law requires that you exercise due diligence.

Here, a vital piece of the puzzle is assessing the security safeguards of third-party vendors. To reduce the potential risks, be in the know when it comes to providers' data protection capabilities and know what to look for in the fine print of any legal contract.

Culture & Community

Names in the News
Jacquelyn Marchand

Read about Commonwealth advisors who have been recognized by and quoted in the financial industry press.

Popular Last Quarter

1. Newly Imposed ISP Data Caps: Have You Hit the Limit?
(Fintech & IT Solutions, 02/23)

2. How Elder Abuse Happens: Two Advisors' Stories
(Compliance & Regulation, 03/04)

3. Be in the Know: 2021 Changes to Medicare Premiums
(Wealth Planning, 01/13)

4. Staff Road Show: 2020 Review
(Staff Room, 01/13)

5. How to Be More Effective at Virtual Training
(Marketing & Practice Management, 01/19)

Directory

To quickly and easily reach a Commonwealth specialist, please follow these steps:
Step 1: Call Commonwealth. / Waltham: 800.251.0080 / San Diego: 877.347.1983
Step 2: Select options 1 through 8 to reach specific departments.
Step 3: Depending on the option you select, there may be additional options.
Step 4: Dial 0 to reach the operator anytime.

1 Trading	
Place a trade	1, 1
Fixed income	1, 2
All other inquiries	1, 3
2 Service Center (Transfer of Assets, New Accounts, Retirement Operations, Cashiering, Account Supervision, General Operations)	2
3 Compliance/Licensing	
Compliance: Branch office examinations	3, 1
Licensing: Insurance licenses, securities exams	3, 2
4 Technology	
Account lockouts and password resets	4, 1
Commonwealth CRM support	4, 2
Firewall and networking support	4, 3
EasySite support	4, 4
All other technical inquiries	4, 5
5 360° Reports and Performance	
Portfolio Reports and Data Services (Client360°®, Practice360°®, and Investor360°® reporting and performance, Quarterly statements)	5
6 Compensation/Advisory Fee Services	
Compensation: Manual and electronic revenue detail	6, 1
Wealth Management or Retirement Plan Consulting fee inquiries	6, 2, 1
All other advisory fee inquiries	6, 2, 2
7 Wealth Management	
Investment-related product support: Mutual Fund Recommended List, product information	7, 1, 1
Research Package: Morningstar® Advisor Workstation℠, Proposal Wizard, Argus, Value Line, Forefield Advisor	7, 1, 2
Advisory platforms sales and marketing support: Fee-based marketing support, Commonwealth Alliance Program (CAP)	7, 1, 3
Separately managed account or unified managed account support: Separate accounts, Unified managed accounts, ETF strategists	7, 1, 4
7 Wealth Management (continued)	
Annuities: Fixed/variable/single-premium immediate	7, 2
Insurance marketing support: Marketing support, illustrations	7, 3, 1
Insurance illustrators: Case managers	7, 3, 2
Retirement plan support: 401(k)s and other qualified plans	7, 4, 1
Retirement plan support: Traditional, SIMPLE, SEP, and Roth IRAs	7, 4, 2
Advanced planning support: Case design support, 529 plans, education funding	7, 5
8 Prospective Advisors	8

Email

Generally speaking, Commonwealth staff email addresses are as follows: [first initial][last name]@commonwealth.com
For example, Kol Birke's email address is: kbirke@commonwealth.com.

Commonwealth Financial Network
29 Sawyer Road
Waltham, MA 02453-3483

PRESORTED
FIRST CLASS MAIL
US POSTAGE PAID
PROVIDENCE, RI
PERMIT NO. 421

Commonwealth's story was built one advisor at a time. You'll find the solutions and expertise to move your business forward, backed by our best resource: the best people. Let us help you succeed.

What Do You Think?
We welcome your questions, comments, and ideas for future articles. Simply email the editor-in-chief, Kate Flood, at *kflood@commonwealth.com*.

The *Commonwealth Business Review* is published quarterly and is for advisor use only. Information contained herein is based on data obtained from sources believed to be reliable; however, its accuracy and completeness are not guaranteed.

Commonwealth

Waltham office / 29 Sawyer Road / Waltham, MA 02453-3483 / Toll-Free: 800.237.0081 / Phone: 781.736.0700 / Fax: 781.736.0793
San Diego office / 110 West A Street, Suite 1800 / San Diego, CA 92101-3706 / Toll-Free: 877.347.1982 / Phone: 619.471.9700 / Fax: 619.471.9701
Commonwealth Financial Network,® Member FINRA/SIPC / commonwealth.com