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Fund wraps steal SMAs' thunder

Faulted for its costs, the product continues to gain market share

By **Jeff Benjamin**
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Mutual fund wrap accounts, sometimes seen as a retail-class underling to more sophisticated separately managed accounts, are gaining a bigger following.

Year-end estimates for the $1 trillion worth of what the Washington-based Money Management Institute calls managed solutions assets shows that mutual fund wraps now constitute 32% of the pie, up from 29% two years ago.

Separate accounts, which offer customized portfolios of individual securities and are sold mainly by wirehouse reps, now account for 46% of the total, down from 57% two years ago, according to the MMI's research.

Part of the appeal of the fund wraps, according to brokerage representatives and program sponsors, is the ease of account setup, portfolio management and access to certain strategies, when compared with traditional separate accounts.

Mutual fund wraps, which package mutual funds and exchange traded funds in portfolios constructed on brokerage platforms, are gaining appeal among investors who are suddenly emphasizing balanced asset allocation over the pursuit of alpha and other separate-account characteristics.

ADDED EXPENSE?

Ted Feight: *Mutual fund wraps are "a nightmare of fees."*

But some financial advisers consider mutual fund wraps an added expense that comes with essentially outsourcing the asset management function.

"Those are for the guys who want to do more marketing and less of the asset management," said Ted Feight, president of Creative Financial Design in Lansing, Mich.

"I kind of chuckle when I see them, because they have the program fees, on top of the mutual fund fees, on top of the rep's fees," he added. "It's a nightmare of fees, all to hire somebody else to watch the managers for you."

The managed accounts industry insists that the fees aren't so egregious, since many of the underlying mutual funds used are in lower-cost institutional shares. But there is no disputing the program fee, which usually adds between 0.2% and 0.5% to the overall management fee.

Driving the rise of fund wrap programs are technology and changes in investment management, according to Jean Sullivan, managing principal of Dover Financial Research in Westwood, Mass.

"We're just seeing an industry transition away from platforms that are inefficient and difficult to use," she said. "Right now, financial advisers are so busy and their client needs are so complex, they need platforms that are easy to use."

Ms. Sullivan, who produced the latest research on the market for MMI, added that the separately managed accounts industry is "more or less on hold," while new unified-managed-account platforms that are designed to blend multiple accounts and investments into a single account are being developed.

"Tax management was always the big reason to do separately managed accounts, but when everything is going down, that doesn't mean anything," said Len Reinhart, president of Reinhart Consulting Group LLC in West Chester, Pa. "In this market, the diversification you can get with mutual funds and ETFs makes more sense to a lot of advisers than does a separately managed account."

Mr. Reinhart's vision is that the separate account will further distance itself from the mutual fund wrap and UMA by raising investment minimums.

"What's already happening is going to accelerate as minimums for SMAs go up and they go back to being truly high-net-worth products," he said. "At that point, mutual fund and ETF adviser programs will dominate."

The separately managed account has long been viewed as the on ramp to fee-based advisory relationships for commission-based brokerage reps, and the large national brokerage firms still represent about 65% of the separate-account market.

Meanwhile, the mutual fund wrap has become the on ramp to fee-based advice for reps at independent brokerage firms such as Ameriprise Financial Inc. in Minneapolis, LPL Financial in Boston, and smaller independent broker-dealers that clear through large broker-dealers such as Pershing LLC in Jersey City, N.J.

"Advisers are still selling, and investors are still buying, into managed money, but what's changing is the delivery mechanism," said Steve Dunlap, chief operating officer with Pershing's managed-account solutions.

In this market, he added, the mutual fund wrap stands out for its ability to allocate client assets to fixed income and international markets in a manner that is more efficient than is sometimes possible with separate accounts.

"I do believe that by using mutual fund wraps for my clients, I'm getting a much higher level of due diligence than I could provide myself, and I'm getting the asset allocation," said Mark Bredin, president of Bredin Investment Services in Malvern, Pa.

Mr. Bredin, who oversees $100 million in client assets, is following the pattern of many advisers in that he has started using mutual fund wraps even for his clients with larger accounts who have traditionally been steered toward separate accounts.

"I'm a former wirehouse broker, and I've found that once you sell a mutual fund to a client, it is very difficult to go and convince that client to sell that mutual fund," he said. "But using a program that sets the asset allocation and picks the mutual funds alleviates those problems."

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