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WHAT I LEARNED THIS WEEK®

Excerpt from March 7, 2019

The future of finance will be female (Part 1).

Mar 07, 2019

Tomorrow is International Women's Day—a day devoted to spotlighting how much progress women have made and how much work remains before gender parity is the norm and not a mandate. Beneath the headlines, a slow-moving secular trend promises to dwarf the pink-washed responses of any hashtag-inspired movement. Women are getting richer. **By 2020, women are expected to hold 32% of total global wealth, roughly $72 trillion,** according to Boston Consulting Group. And this number will continue to grow. **Women are expected to inherit 70% of the wealth that will be passed down over the next two generations.** While women's votes and purchases are increasingly impacting the conversation, their real influence will manifest as their wealth grows. **How and where women choose to invest and how they educate their children about legacy, investment and philanthropy will be one of the most influential forces shaping the world looking forward.** It is arguably also one of the most hopeful.

Here's what we know.

The wealth management industry—a sector developed for and run almost exclusively by men—must adapt to meet the needs and expectations of its quickly-expanding female client base.

This means many things. It means that financial advisors need to understand women's unique needs, goals and views towards money. Women gather information and process information about money differently than men. This does not mean that it needs to be dumbed down and painted pink. Sadly, this is the approach of many of the financial products being marketed for women today. [As excited as we are about the concept of Sallie Krawcheck's Ellevest platform, we have been somewhat put off by the site's gratuitous communications. Smart women do not want to be referred to as "Elle raisers" any more than we want to invite our "Galentines" to invest on "Galentine's" Day.]

While men focus on returns and industry benchmarks, women tend to prefer a goal-based approach. M.P. Dunleavey, the senior finance editor for *The New York Times*, shared a telling anecdote a few years ago:

> *I was out at dinner with a friend and her husband when they started squabbling about her financial adviser.*
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> *"I love her," said my friend, a successful six-figure earner, praising a new plan to balance her personal and financial priorities. "She totally gets me."*
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> *Her husband, equally successful, said the adviser didn't impress him much. With the market up about 30 percent in 2013, how could his wife's portfolio have returned only 10 percent?* ***My friend said that her returns were fine, and, even more important, that the adviser understood her goals.*** *Yes, her husband said, but goals require this thing called "money."*
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> *He wasn't wrong. But neither was she. In fact, their Mars-Venus-and-money moment was an uncanny echo of an issue that's bedeviling many financial companies:* ***The data-driven approach of traditional firms is alienating many women. And the way that women prefer to deal with money—holistically, emotionally****—can be baffling to the guys on Wall Street.*

Thirty years ago, Lori Van Dusen, CEO of LVW Advisors, was an outlier in the wealth advisory world. **She invested her clients' money based on their goals—a bucket for essentials, one for aspirations, and one for legacy.** The different goals determined the risk tolerance. In the past few years, many of the big, advisory firms have adopted a variation of this goal-oriented methodology.

Not only did Van Dusen recognize how to relate to the female investor, her approach foresaw two more recent trends—behavioral economics and indexing.

In 2017 Richard Thaler won the Nobel Prize in economics for his pioneering work in behavioral economics. Investors, Thaler found, do not behave rationally, rather they tend to be risk averse when it comes to gains but risk-seeking if they are facing losses. This can have unnerving consequences, like panic selling. **Goal-based investing is a type of "nudge" that prevents investors from making bad timing decisions on their investments.**

Meanwhile, index funds have become increasingly commonplace. Individuals can now get professionally-constructed portfolios matching their risk level, or, alternatively, their goals, from robo-advisors for just 0.25% of assets a year. **To earn their keep in this environment, advisors must now offer a more personalized, high-touch approach.** As Sanjiv Das, a finance professor at Santa Clara University, explained recently to *Forbes*: "If you can tell people, 'I'm working to reach your goals,' it's more understandable than if you say, 'Your portfolio has an expected return of 10% and a standard deviation of 20%.'" Moreover, goals change as we age. If a client needs to report when her dreams or circumstances change, that helps builds a relationship with an advisor that cannot be achieved with a robot.

Women are master relationship builders. (This is not to say that men are not, only that the female brain is uniquely suited to excel at this skill, as we explain in *WILTW* January 18, 2018). **The surest way for financial advisory services to serve their quickly-expanding female client base is to hire more women.** According to the CFP board, only 23% of Certified Financial Planners in the U.S. are women.

As underrepresented as women are in financial advisory roles, they are rarer still in the world of asset management. Of the 16,084 portfolio managers tracked by Citywire around the world, just 1,662, or 10.3%, are women. In the U.S., that figure falls to 9%. There are multiple social and structural reasons for this, but it is clearly not because women are bad at managing money. To the contrary, a rigorous 2015 Morningstar demonstrated that women are every bit as good at this job as men.

Indeed, a growing body of research indicates that women are actually better investors than men. **The irony is that male investors tend to be "too emotional."** Men are more sensitive to news events than women and tend to buy and sell shares as a result. Men also have a more difficult time when things go wrong—they tend to hold on to shares in the hopes they will recover whereas women cut their losses and move on.

As Neil Stewart, a professor at the Warwick Business School who authored a 2018 study on the habits of men and women traders, sees it: "Men are just a little more likely to be drawn to more speculative stocks, whereas women are more likely to focus on shares that already have a good track record. Women also take a more long-term perspective, trading less frequently. This possibly means women are investing more to support their financial goals, whereas men are attracted to what they see as the thrill of investing."

In the wake of #MeToo, the call for gender diversity and wage equality is growing. Just as women are divesting from companies and brands that fail to champion women, **they will no longer feel comfortable keeping their money in the hands of companies with exceedingly few female portfolio managers.** Attracting, retaining and promoting female fund managers is a tall order for the industry, but it is paramount. Those that figure out how to accomplish this sooner will enjoy an outsized advantage.

What does the rise of women investors mean for indexing?

In a recent op-ed for *The Financial Times*, Ellen Carr, a portfolio manager and adjunct professor at Columbia Business School, suggests that the dearth of female fund managers helps explain the outflow of funds towards passive strategies in recent years:

> *This brings me to my final piece of advice—not for the student but for the active money managers who should be recruiting her. I won't waste too much time on the failure of active management. But here's a thesis:* ***perhaps alpha is rare because alpha males are mostly in charge of generating it.*** *The seminal (no pun intended) study of male versus female investors showed that women had better results than men.* ***What if the way to reverse the shift to passive investing is by giving more women the chance to manage money?***

Now consider the comments made by value investor Bill Miller in a recent interview with *Institutional Investor*: "Since the financial crisis, active management has been just as bad a deal, if not worse, because so many managers have become closet indexers…The managers who survive will be those who run concentrated portfolios, don't worry about volatility or the price you pay for performance, and aren't concerned about tracking error." The managers he is describing are less reactive and short-term than today's typical male manager.

Risk, Return and Impact

Women see an economic role for finance beyond pursuing alpha or market-beating performance. **Women, much more so than men, are drawn to investments that have a positive social or environmental impact.**

Arguably, the ascent of female and millennial investors is the biggest driver behind the recent growth of impact investing and ESG data. A niche market today, accounting for just $250 billion of global capital allocation, impact investing will expand dramatically as baby boomers transfer $31 trillion to spouses and children over the next two decades. (Not surprisingly, the female fund manager is less of an outlier in this flourishing corner of asset management—33% of the 2017-18 ImpactAssets 50 fund managers were led by women.)

Impact investing sets the bar higher than socially-responsible funds which merely exclude certain companies from their portfolios. **Impact investors want to make decisions based on risk, reward and on the amount of "good" an investment produces in the world.** For women and millennials, this "good" is not contingent on conventional investment-return metrics. In the face of global population growth, income inequality and climate change, risk and opportunity in 2019 are very different from 1989.

This was the essence of Christine Lagarde's Tacitus Lecture delivered in London last week:

> *I believe that we can build a better financial sector—one that is safer, more sustainable, and ethically sound. A financial industry with a broader sense of purpose.*
>
> *In this vein, the U.K. has launched a national conversation on how to enhance the social impact of investing—furthering the goal of doing good while making a return.*
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> *This goal is not just morally just; it is economically right. Why? Because a better financial sector is more important than ever to help deliver on what our 21st century so badly needs: higher employment, greener growth, and good living standards for all.*
>
> *The key to achieving this goal is to reshape finance into something that is more aligned with societal values and more connected to the interests of all stakeholders: from customers, to workers, to shareholders, to local communities and future generations.*

Arguably the loftier goals of impact investors, including the ongoing assessment of how well companies manage their ESG risks, **will be better served through active management.** As one female fund manager recounted recently: "Contrary to popular belief, millennials are *not* willing to accept a trade off between returns and impact. They expect you to *beat* the market and they want you to do it sustainably. . . Millennials, especially females, research everything and are highly demanding clients for any industry."

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