

The New World of Retail Brokerage: What Can a Fiduciary Do?

By David Aferiat

TRADE IDEAS LLC



Our outlook assesses both recent structural changes in the industry, as well as some indications around where the market is headed.

The Industry

The effects of the recent move to \$0 on trading commissions by the major retail online brokerages, followed rapidly by Schwab's announced intention to acquire TD Ameritrade are still being felt. As one industry participant comments: "We are a new brokerage in a new world." Among other changes, there will be an emphasis on APIs—for technology outside the broker's four walls to capture flow. For fiduciaries, two immediate effects are: the question of how to retain and build the customer base at scale; and the implications moving upstream in boutique and global wire houses (and family offices) for their wealth management services. Consolidating firms will allow them to deliver services at enormous economies of scale, yet uncertainty persists: will existing TD RIAs repaper their accounts with Schwab or take a leap elsewhere?

For brokers, some of the revenue loss will be covered by payment for this captured order flow. Yet paradoxically, the move may in fact provide an opportunity for fiduciaries, now free of the commoditized fight to the bottom around fees, to move to a much more professional offering, rooted in value added services around insight, research, tools, information, data, and support. All this requires investment in innovation to either stave off new entrants or increased churn. There will be fees for these services either on a bundled or a la carte basis. For firms that rapidly move to that reality, the future is bright, for those that don't, well...

For RIAs and FAs specifically, the game now shifts entirely to the customer. After trading for "free" and seeing worse results, retail investors will now look, on the advisor side, to the investment plan, the return, and execution quality. Services will rapidly become differentiators, and, similar to the professional market, firms will be judged on a simple metric—the ability to outperform the competition. How firms leverage

technology will determine that ability. Adaptive technologies, like machine learning AI and others for improving communications, managing risk, and capturing alpha opportunities, will see adoption rates soar. This will affect all wealth managers, FAs, and RIAs, whether affiliated with a firm or independent.

The Market

Look for an uptick in GDP and the economy through year end 2019 and Q1 2020, with The Fed reinitiating rate increases. As the election season heats up, there will be the predictable slowdown given the uncertainty and with attendant increases in volatility. The effect of unpredictable movements in the impeachment need to be taken into account as well (which argue for event tracking capabilities such as those provided by Trade Ideas).

Currently, the market has made new highs and is now slightly above its trading band. The absence of momentum at this point may lead to a short term market correction. Many winners reporting this quarter have moved up nicely only to lose momentum. The market trend up is still intact but does not appear to be ready to melt up. In the absence of momentum a near term pullback may be expected.

Active investors may have an advantage here by buying oversold securities and selling overbought issues once momentum has ceased. The recent New York Times bestselling book entitled "The Man Who solved The Market". How Jim Simons Launched The Quant Revolution reveals that the Medallion Fund has had an annual return of 66% per year since 1988. \$100 billion in profits. Recent \$7 billion annually in trading gains with a recent holding period of about two days.

The great white whales of investing as supreme predators know the habits of their prey and take advantage of them on a consistent nonrandom basis. Thirty percent of stock market volume is attributable to Quant based traders. The prey has to get smarter at this game to survive long term.

The economist Kenneth Boulding favored the principle that in period of transition it is not the well adapted who survive, but those who adapt well.

The watchword for 2020 is adaptation. ■

David Aferiat is Managing Principal of Trade Ideas LLC.

Learn more at www.trade-ideas.com.

