



FOUR HABITS OF HIGHLY SUCCESSFUL ADVISORS



The wealth management industry is in a constant state of evolution, and the next five to seven years will see a pace of change that will make Moore's Law proud.ⁱ

As a starting point to address taking advantage of this accelerating change, it is worthwhile examining some of the trends within the wealth management industry since the “Great Financial Crisis” and the “COVID-19 Era.”

At a macro level, one tectonic shift facing advisors is that the growth and evolution of disintermediated information, social media and online “advice” continue to be disruptive forces on the wealth management industry. The next generation of investors is technologically savvy, more collaborative, less trusting of tradition and more socially conscious.

Other trends include:

- + End clients view professional investment management as “table stakes”—that is, it is viewed increasingly as a commodity.
- + End clients are more cost/value/tax sensitive.
- + End clients are increasingly interested in/open to more nontraditional investment approaches and solutions.
- + Advisors seek to build enterprise value in their firms through scale and efficiency.
- + Advisors want to deliver institutional-quality investment portfolios while being able to focus on holistic wealth management advice—the services end clients are increasingly willing to pay for.
- + Advisors are increasingly open to outsourcing as a means of driving scale and efficiency in their practices.

What this means for wealth managers and advisory professionals, who frequently define *themselves* primarily as *investors*, is the need to recognize that what future clients will want from them are simplicity in their interactions and *solutions* to their financial problems and concerns. Those solutions extend well beyond just investment solutions. Issues like wealth transfer, tax optimization, philanthropy, impact investing, family governance, intergenerational cooperation, personal counseling and estate planning will be of critical importance.

How, then, should advisors be building portfolios and running their businesses? How can they help clients achieve evolving goals and objectives and/or take advantage of industry trends? Are there “best practices” among successful, profitable, and fast-growing advisors that can be identified, analyzed and adopted?

We believe the answer is yes.

We are privileged to work with some of the most successful and sophisticated advisors and financial institutions in the country. These firms are winning business in a highly competitive marketplace. They are building and managing differentiated investment portfolios and running their enterprises efficiently and profitably. We are in a position to observe them and see what they are doing to set themselves apart.

Here are four “habits” we see being employed by successful advisors in addressing the sophisticated demands of high net worth (HNW) investors.

HABIT ONE: TO INCREASE ENTERPRISE VALUE, FOCUS ON SCALE, EFFICIENCY AND PROFITABILITY, NOT AUM OR AUA

Many advisors believe their “enterprise value”—the value of their practice—is measured in terms of a multiple of their assets under management or advisement. It certainly is true that if you sell your practice for a certain dollar amount, you can translate that into a multiple of your assets.

But that is not what the buyer is actually paying for.

According to research done by *Investment News*ⁱⁱ, what buyers pay for are *scale*, *efficiency*, and *profitability*.

As a simple example, a firm with \$1 billion in AUA that breaks even from a profitability perspective is probably worth less than a profitable firm with \$500 million in AUA.

According to *Investment News*, some of the more commonly used metrics for evaluating enterprise value include the following:

+ **REVENUE PER PROFESSIONAL:** This simple metric captures the amount of revenue generated per client-facing professional at the firm. This is a measure of enterprise *productivity* and *efficiency*.

+ **EARNINGS BEFORE OWNER COMPENSATION (EBOC) AS A PERCENTAGE OF REVENUE:** This is a profitability metric somewhat unique to RIAs. Most financial professionals are familiar with the concept of “EBITDA”—earnings before interest, taxes, depreciation and amortization. This is a commonly used metric for evaluating the actual “working earnings” of a company derived by carving out extraneous and non-recurring expenses.

EBOC is a similar metric that is used to evaluate the “working earnings” of an owner-operated enterprise like an RIA (and, of course, there may be multiple owners). Consider the example of an owner-operated RIA where the owner is considering monetizing their firm’s value three to five years into the future. There is nothing to prevent that owner from cutting or perhaps even eliminating their compensation to “goose” the net profitability number and increase the perceived value of the enterprise.

This is not to suggest that owners are nefarious and looking to “game the system.” But by removing owner’s compensation from the profitability evaluation, you simply remove even the temptation to do so.

Alternatively, an owner may be maximizing their current income by taking home most of the profitability each year. But that expense will be eliminated (or managed) once the firm sells, so it makes sense to remove it from consideration.

+ **COMPOUND ANNUAL REVENUE GROWTH RATE:** This is a *scalability* metric and is just what it sounds like—a measure over time (typically three or five years) of the compound annual revenue growth rate of the enterprise.

What do these metrics have in common? They all focus on the scale, efficiency, and profitability of the firm, not the level of assets.

Now, here come a couple of paragraphs that may rub some advisors the wrong way.

Many, if not most, advisors get into the wealth management business because they love or are interested in investing—they like managing client portfolios and view that as one of their primary value propositions.

But here is the dirty little secret—*very few firms get paid for their research capabilities*. There are exceptions, of course. But in most cases, the potential buyer already has an investment solution in place (either internal or outsourced). The buyer may retain some of the research professionals of the acquired firm, *but that is not what they are paying for*.

What this means is that if you operate an RIA that has less than \$1 billion–\$2 billion in assets, and your goal is to maximize your enterprise value for a potential buyer, you are better off driving scale, efficiency, and profitability by outsourcing all or some of your portfolio management function (including middle and back-office functions).

WisdomTree conducted extensive research from 2019–2020 into the biases and preferences of both financial advisors and their end clients—we surveyed and interviewed thousands of end clients and hundreds of financial advisors.ⁱⁱⁱ

Some of our key findings included the following:

**90% of
end-client investors**

welcome third-party models
into their portfolios

**70% of
end-client investors**

believe third-party models
will improve their portfolio
performance

**75% fewer
investors**

would consider leaving their
current advisor if they knew
that advisor was using
third-party models

We will examine more research on the topic of outsourcing later in this paper. For now, the key point is that if you want to optimize your enterprise and the value of your firm for an eventual monetization, succession, or liquidity event, your focus should be on driving scale, efficiency, productivity, and profitability, not just gathering assets and managing portfolios.

HABIT TWO: SEGMENTATION AND FINDING YOUR NICHE

Many advisors set minimum investment levels for accepting clients—\$500,000, \$1,000,000, \$5,000,000 and so forth.

There is nothing wrong with that, and in fact, if you set a reasonable minimum based on your opportunity set of clients (and then stick to that minimum!), it will help drive scale into your practice.

But the most successful advisors take it one step further, identifying a specific market niche or segment and then seeking to be “the” advisor for that niche. This is a viable way to establish a brand for your firm that is outside the crowded marketplace.

We like to use the simple example of deciding to be “the advisor” for people who collect watches. What do we know about this niche market?

1. If you collect watches, you probably have an elevated level of net worth and/or disposable income.
2. If you’ve ever met anyone who collects watches, you know they *love* to talk about their watches (feel free to substitute in jewelry, art, cars, or any other collectible).
3. They love to get together with other watch collectors and talk about watches.

So, imagine if you became the world’s expert on collectible watches and the typical financial objectives of the people who collect them. You have a built-in market niche that is narrow enough for you to dominate and deep enough to build a thriving practice around.

Those are the keys—narrow enough to dominate and deep enough to build a practice around. It doesn’t matter what that niche market is—just identify one and build your practice around it.

We know many advisors who have done so successfully, be it around medical professionals, small business owners, lawyers, real estate developers, multigenerational wealthy families, or whatever it may be.

A recent article in the IWI Investments & Wealth Monitor highlighted this segmentation strategy^{iv}. Three advisors were interviewed about their successful practices, and all stressed the importance of successful client segmentation.

1.

One advisor runs the wealth management arm of a successful sports agency, and all his clients are professional athletes. He outsources the investment management function to a third party so he can focus on everything else his clients need—cash management, insurance, bill paying, tax preparation, estate planning, etc. In a highly competitive marketplace, his new clients seek him out because of the word-of-mouth references he gets from existing clients, which include some of the most well-known athletes in the world.

2.

A second advisor focuses his practice on entrepreneurs, small business owners, and corporate executives, all of whom place a high value on estate and financial planning, business transition and succession planning, taxes, and wealth transfer. His geographical footprint is fairly small, and many of his clients know each other and act as active references for him with potential new clients, and his practice is thriving.

3.

A third advisor focuses her practice almost exclusively on the divorced female spouses of wealthy New York executives and hedge fund/private equity managers. She counsels them through the divorce and helps them become self-sufficient in managing their own finances post-divorce. Her practice is booming, and she has become a national spokesperson on empowering divorced women to take control of their own financial lives.

Three quite different market niches, but all with the common characteristics of being deep enough to grow a practice and narrow enough to be one of “the brands” in those market segments. The point of the story is to find your niche, develop the appropriate expertise for that niche, and then get busy.

HABIT THREE: OPTIMIZE TAXES AND ACTIVE MANAGEMENT FEES

It is a well-known market adage that the only investment aspects an advisor really has control over are “fees and taxes”; they cannot control market movements.

Well, this is a market adage because it is true. Optimizing fees and taxes represents putting real money back into the pocket of your end clients—ideally, enough to cover your advisory fee and then some.

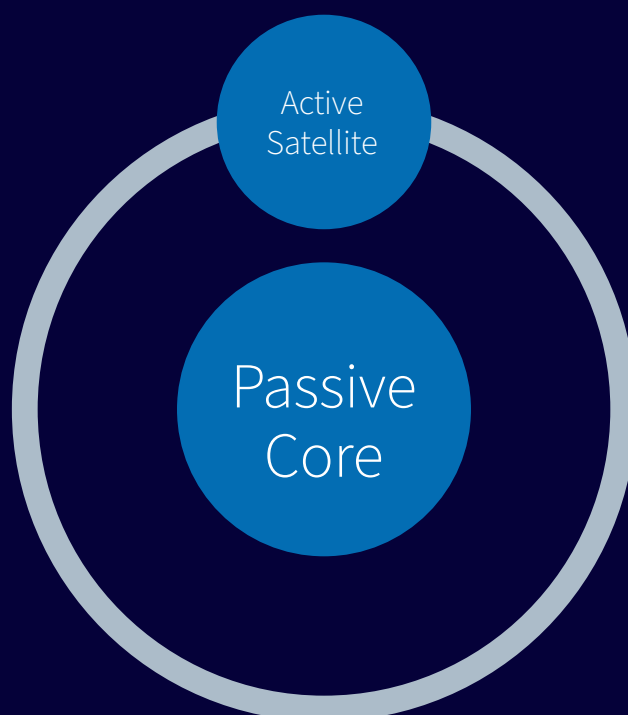
Optimizing Active Management Fees

Most advisors are familiar with the concept of “core/satellite” portfolio construction (sometimes referred to as “core and explore”), but let’s define terms, so we are working from a similar framework.

The idea is to build an inexpensive and passive “core” portfolio, typically using ETFs, in an attempt to build a desired market exposure (or “beta”) portfolio in a cost- and tax-efficient manner. Then surround that core portfolio with actively managed “satellite” managers in an attempt to add net-of-fee outperformance (or “alpha”) to the overall portfolio. Historically, those active managers have come by way of mutual funds or, for larger clients, separately managed accounts (SMAs).

To understand the notion of adding “alpha,” we also need to remind ourselves of the concept of “active risk.” Simplistically, active risk can be thought of as “bets” (over-weights, under-weights, factor tilts, etc.) an active manager takes away from the underlying benchmark to generate outperformance versus that benchmark.^v

So, the goal of a core/satellite portfolio is to deliver cost- and tax-efficient outperformance relative to a defined benchmark (e.g., the S&P 500 Index or the MSCI ACWI Index for an equity portfolio).



Source: WisdomTree. For illustration purposes only. Does not represent a specific investment or investment advice.

Building a Better Mousetrap

Fees matter—especially over long-time horizons.

The asset-weighted average expense ratio for active funds was 0.60% in 2021. That is exactly five times the asset-weighted average expense ratio for passive funds (0.12%) at that time.^{vi}

The illustration below highlights just how much of a difference higher fee investments can make over time.



Source: <https://weabenefits.com/resource/fees/>
Illustration assumes an annual contribution of \$5,000 and an annual rate of return of 7% over a period of 30 years. This is for illustrative purposes only and is not indicative of any investment.

The satellite component of the portfolio was historically constructed using actively managed mutual funds and/or SMAs. But what if you could build the satellite portfolio with structurally advantaged ETFs? Enter the **WisdomTree Outcome-Focused Model Portfolios**.

We built these models with “satellite” very firmly in mind.

While they can be—and are—used as stand-alone models, they were built specifically to complement already existing portfolios to achieve specific investment mandates.

Our Outcome Focused models include the following:

- + **GLOBAL DIVIDEND:** An all-equity portfolio seeking to optimize both total return and risk-adjusted yield.
- + **MULTI-ASSET INCOME:** Exactly as it sounds, this portfolio includes stocks, bonds and other assets in an attempt to optimize both total return and risk-adjusted yield.
- + **MULTI-FACTOR:** An all-equity portfolio that seeks to improve the risk factor diversification of an overall portfolio while still generating positive total return. This model is available in U.S., EAFE, and EM versions.
- **VOLATILITY MANAGEMENT:** A portfolio allocated to nontraditional or “alternative investment” strategies, including equity long/short, managed futures, diversified arbitrage, short-biased, and options-based. The investment objective of including this portfolio is to improve the overall diversification of the portfolio by including lower correlated strategies and thereby deliver more consistent performance over full market cycles.
- **DISRUPTIVE GROWTH:** Exactly as it sounds, this portfolio is “hyper-growth” and seeks to take advantage of evolving or disruptive trends in the workplace, platforms, cloud computing, financial technology, cybersecurity, biotech and genomics, video games and esports, and sustainable investing.

If you know WisdomTree, you know we are not a passive beta shop, even though we are an ETF shop. All our products have one or more embedded “factor tilts”—dividends, value, size, quality, earnings, and so forth.

In other words, all our strategies take “active risk” relative to an underlying passive beta index—risks that we believe, both academically and empirically, have the potential to deliver “alpha” over full market cycles in comparison to passive beta.

Think about an actively managed mutual fund (the typical component of a “satellite” portfolio). What is it? It is a portfolio manager (or team) taking on active risk in an attempt to deliver net-of-fee alpha, right?

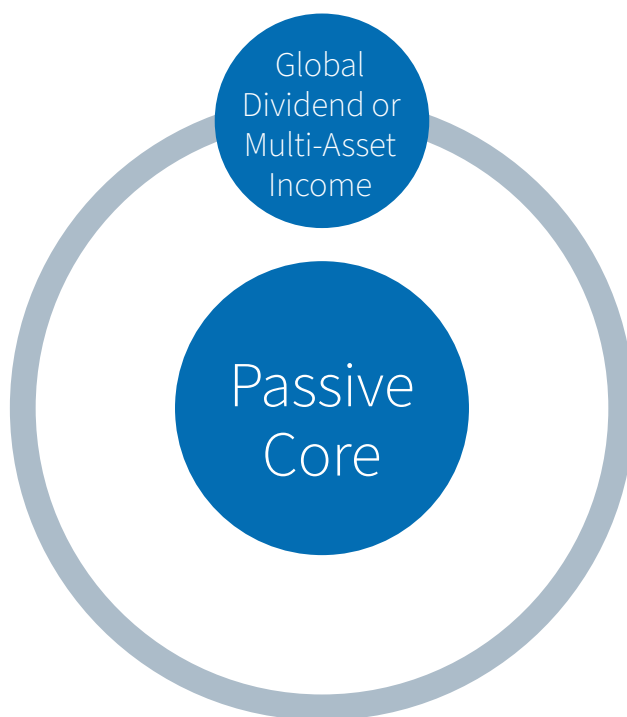
Well, that is precisely what WisdomTree does.

The difference is that our active risk “bets” are rules-based and quantitative in nature. We are one of the few asset managers that “self-indexes”—we define a quantitative and rules-based filter or screen for a given product, develop an index around those defined screens, and then wrap an ETF around that index.

So, in many respects, despite being an ETF shop, most of our products are more accurately compared to actively managed mutual funds than passive beta products. We typically will be more expensive than the passive beta product but much less expensive than the more comparable mutual funds while taking on similar active risk.

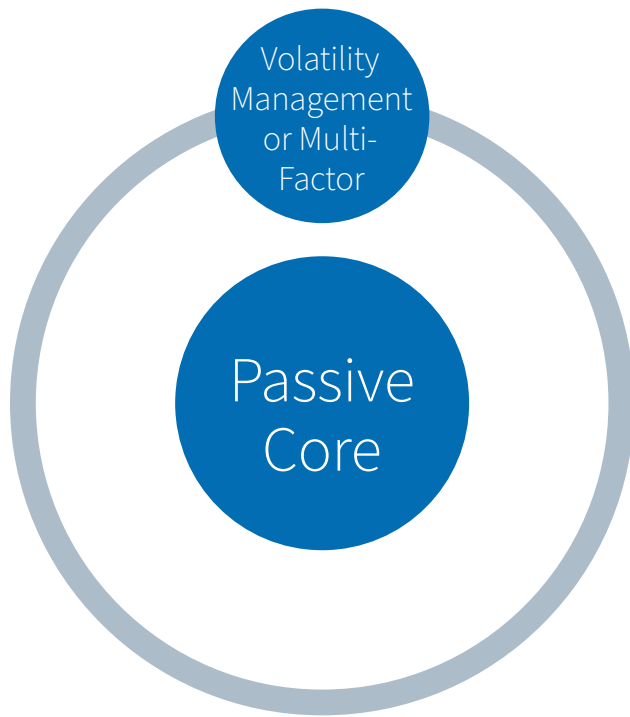
So, let’s visualize some potential “core/satellite” portfolios using WisdomTree Outcome Focused models versus actively managed mutual funds.

1. The purpose of the satellite is to optimize risk-adjusted income

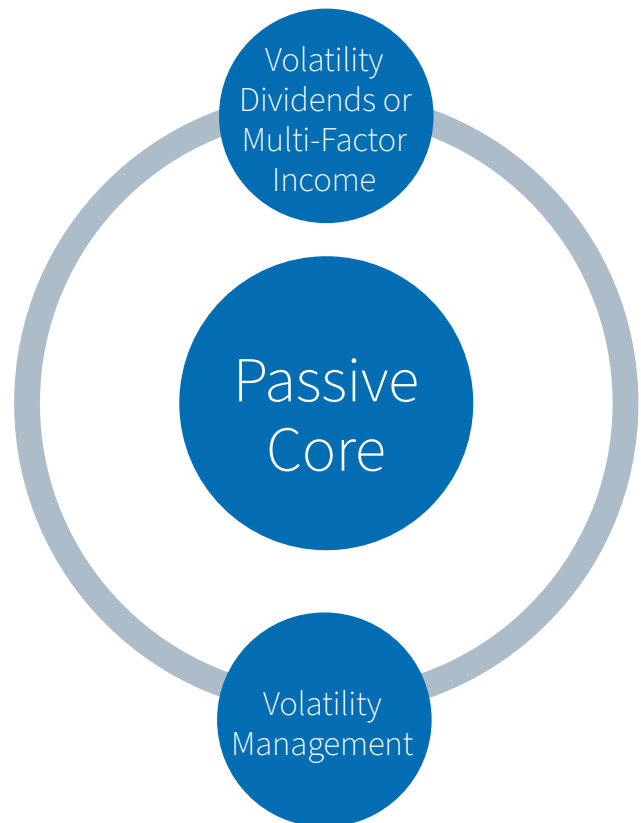


Source: WisdomTree. For illustrative purposes only. Does not represent a specific investment or investment advice.

2. The purpose of the satellite is to increase the overall diversification of the portfolio



3. The purpose of the satellite is to optimize risk-adjusted income and overall portfolio diversification



Source: WisdomTree. For illustrative purposes only. Does not represent a specific investment or investment advice.

The beauty of “core/satellite” portfolio construction is that the possibilities are endless—you can construct the satellite portfolio with myriad investment objectives and populate it accordingly.

We built our suite of Outcome Focused Model Portfolios with this flexibility in mind. They are designed and managed to address a number of potential investment objectives and can be mixed and matched to meet multiple objectives. A primary purpose in doing so is to optimize active management fees and make “core/satellite” portfolio construction easy to implement using what we believe is a more cost- and tax-effective approach: a “better mousetrap.”

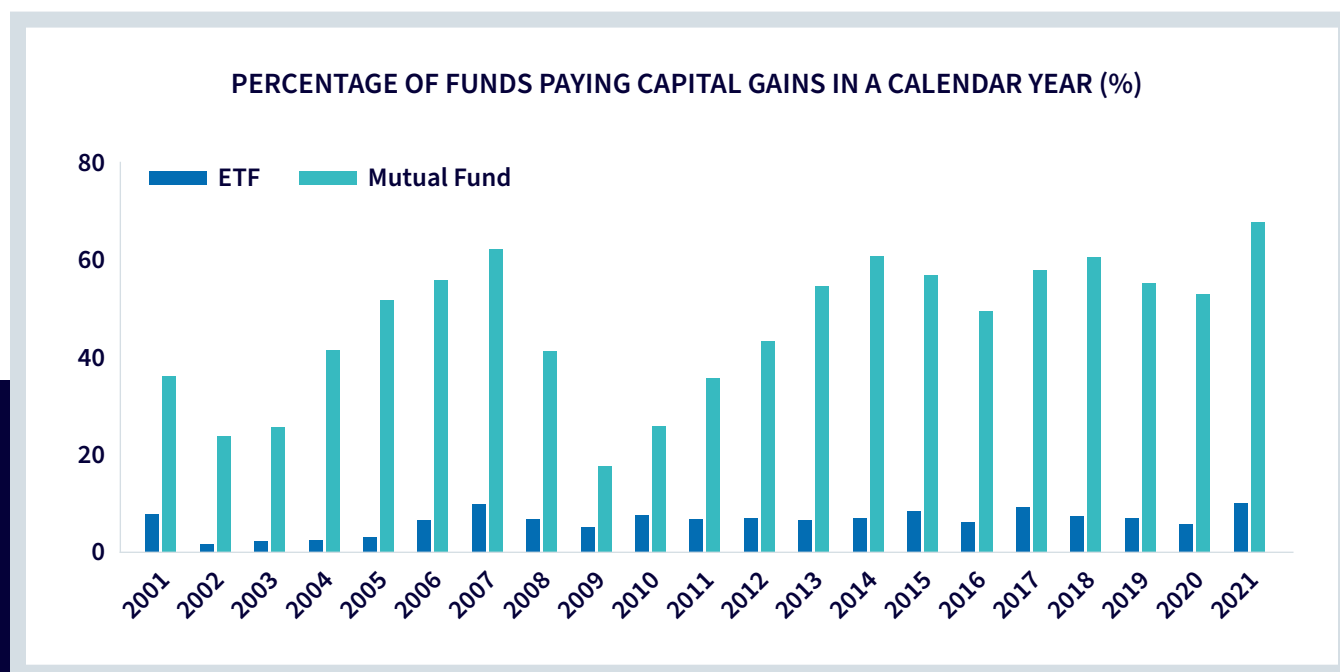
Optimizing Tax Efficiency

Tax efficiency is the second step in the “controllable alpha” aspects of portfolio construction. There are two levels of tax efficiency that advisors should be cognizant of: the investment wrapper level and the client account level.

We already highlighted the investment wrapper—ETFs have historically paid fewer capital gains than their mutual fund peers.

How does this lead to alpha?

A study by finance professors at Villanova and Lehigh universities quantified that an ETF’s tax burden was 0.92 percentage points less than the typical mutual fund over the past five years. The following chart is from Morningstar:



Source: Morningstar, as of July 31, 2022 based on SPDR Americas Research Calculations.

The second level involves the client account—specifically the tax lots of her ETFs, mutual funds, bonds, stocks, etc. The tax management of accounts involves tax-loss harvesting, tax-aware transitions and tax-aware withdrawals. These services can be quite complex.

The good news?

Active tax management of portfolios is no longer the exclusive territory of high-net-worth clients who have access to separately managed accounts (SMAs).

Advisors can now access technology platforms that perform tax portfolio transition services and ongoing active tax management of the overall portfolio.

WisdomTree partners with a variety of trading platforms that can and will engage in the tax management of ETF portfolios. Advisors can work with these platforms to transition existing portfolios into the desired portfolio in a tax-efficient manner based on client objectives and constraints, and then actively tax manage the new portfolio on a go-forward basis.

How does this lead to alpha? The fintech platform 55ip reported that for accounts that utilized its ActiveTax Technology® overlay for all of 2020, advisors generated an estimated average of 2.58% in tax savings for their clients.^{vii}

To summarize, WisdomTree's ETF structural bias, the "active risk" embedded into all our factor-tilted strategies and our partnership with technology platforms that enable active tax management of portfolios all combine to help advisors optimize the two things they have the most control over from an investment perspective: fees and taxes.

HABIT FOUR: ACTIVE ADOPTION AND EMPLOYMENT OF THIRD-PARTY MODEL PORTFOLIOS

Many advisors believe one of their primary value propositions is the construction and management of client investment portfolios.

There is nothing wrong with that. But many other advisors are increasingly seeking to outsource some or all of that function to a qualified model manager—what the institutional world calls an “outsourced CIO.”

These advisors are choosing to focus their activities on their core competencies—niche branding and segmentation, financial and estate planning, family governance, business development and relationship management—and outsourcing at least some portion of the investment management function as a way of improving productivity, efficiency or (potentially) performance.

It comes down to partnering with outsourcing firms like WisdomTree to deliver institutional-quality investment solutions so the advisor can focus on delivering core competencies and boutique-quality value-added services.

Our own market research indicates that many advisors want to be involved in the portfolio management function for their clients and view that capability as a primary value proposition. We don’t second-guess that perception, but we do point out that end clients are much more accepting of third-party models than many advisors believe.

Other industry surveys support this and point out the potential benefits of outsourcing:

- + **ADVISORS USING THIRD-PARTY MODEL PORTFOLIOS** are realizing four times the asset growth and nine times the productivity growth of advisors who do not.^{viii} We are not seeking to replace a firm’s investment solution; we position ourselves as an extension of already in-house capabilities.
- + **THIRD-PARTY MODEL PORTFOLIOS** have grown in AUM to an excess of \$5 trillion as more advisors realize the potential benefits of outsourcing.^{ix}

Focusing on the Left Side of the Decimal Point

In a highly volatile, potentially low-return market regime, advisors need to think differently about what “adding value” means in constructing and managing investor portfolios.

We believe too many advisors spend too much time focusing on investment activities that potentially add value in basis points rather than “handles.” We refer to this phenomenon as “focusing on the right side of the decimal point.”

Advisors who are most successful in growing their practices spend far more time focusing on the “left side” of the decimal point—that is, on those activities that add the most value to investors’ financial lives. In terms of actual long-term value to a client portfolio, for example, we believe the “hierarchy of added value” might look something like this:

1. **Estate planning**
2. **Asset allocation**
3. **Cost and tax management**
4. **Institutional-quality portfolio management**

Summarizing our “four habits of highly successful advisors” illustrates how advisors can incorporate this “hierarchy of added value,” as well as address the specific trends and objectives of increasingly sophisticated investors:

1. **TO INCREASE ENTERPRISE VALUE, FOCUS ON SCALE, EFFICIENCY, AND PROFITABILITY, NOT AUM OR AUA.**
2. **SEGMENTATION AND FINDING YOUR NICHE.**
3. **OPTIMIZE TAXES AND ACTIVE MANAGEMENT FEES.**
4. **ACTIVE ADOPTION AND EMPLOYMENT OF THIRD-PARTY MODEL PORTFOLIOS**

Of course, there are advisors who enjoy significant success without employing any of these ideas, or perhaps just a few of them. But, in our experience, advisors who do employ these “best practices” are enjoying faster growth, improved operational efficiency, enhanced client advocacy, and increased profitability—and therefore increased enterprise value.

Not a bad outcome.

Want to learn about how WisdomTree can help? Visit [WisdomTree.com/Portfolio-and-Growth-Solutions](https://www.wisdomtree.com/Portfolio-and-Growth-Solutions) for more information or email wtpg@wisdomtree.com.



GLOSSARY

Alpha: Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.

Beta: A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

MSCI ACWI Index: A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

S&P 500 Index: A market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

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Diversification does not eliminate the risk of experiencing investment losses.

You cannot invest directly in an index.



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With respect to Dr. Stephen Covey for his “The Seven Habits of Highly Successful People,” Simon & Schuster, Anniversary Edition May 2020.

- ⁱ Moore’s Law, named after Intel Co-Founder Gordon E. Moore, states that computer processor speeds, or the overall processing power of computers, will approximately double every two years. When referenced outside of technology, it generally is taken to mean a state of accelerating change.
- ⁱⁱ See “Three ways top-performing firms stand out” by Msirindes, Investment News, 10/8/14.
- ⁱⁱⁱ Source: WisdomTree’s Models Research Initiative. Interviews conducted 10/16/19–7/21/20. WisdomTree’s Models Research Initiative maintained a +/- 2.3% margin of error among consumer investors across generations and a +/- 6.2% error rate among financial advisors. A mixed methodology was applied that included a robust base of more than 2,000 constituents in the models’ value chain, as well as dozens of in-depth interviews that were conducted on the topic.
- ^{iv} See “Client Segmentation and Its Impact on Growing Enterprise Value,” a facilitated discussion with three successful advisors, IWI Investments & Wealth Monitor, March/April 2021, pp.33–36.
- ^v The seminal paper on active risk is “How Active is Your Fund Manager” by Martijn Cremers and Antti Petajisto, first published as a working paper in 2006. It can easily be found by searching on the title and authors.
- ^{vi} 2021 U.S. Fund Fee Study. https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt36de8b5594de0582/62c6e888181754349ea2fa66/U.S._Fund_Fee_Study_2021.pdf.
- ^{vii} <https://www.wisdomtree.com/blog/2021-03-19/the-so-called-certainties-in-life-seem-a-lot-like-mutual-funds>
- ^{viii} BlackRock Models Survey, 2020.
- ^{ix} Broadridge Whitepaper, 2022: <https://www.broadridge.com/resource/the-rise-of-model-portfolios>.

