

Reconstructing Wall Street
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What Happened

Calculations of how and why the capital markets lurched so completely off the rails last year will occupy academics for a very, very long time. It should. The speed of this train wreck was astonishing. While the big wheels really started slipping back in 2005 when the mortgage industry began to unwind its collective book of badly underwritten subprime loans, the ultimate derailment in the autumn of 2008 was sensational.

Suddenly, enduring U.S. investment banks had disappeared, credit markets had ceased functioning normally, and the government had begun nationalizing financial systems. Politicians were, and are, pulling a few of the levers on the great free market train.

The implications for the U.S. financial services companies are, of course, extraordinary. This hasn't been just a historic correction *on* Wall Street; this is a fundamental rearrangement *of* Wall Street.

A Different Environment

As consumers reorganize and the global economy reorders, the money management industry confronts a more profoundly uncertain business environment than it's ever faced. Uncertainty surrounds not only the depth and extent of the disorder but also the very future of global economic order. And uncertainty of this magnitude is bound to leave some industry executives lost in the fog. The task of industry *leaders*, then, is to overcome the abstractions and begin shaping the future.

While the rebuild is only just beginning, the firms and managers that are to bring order out of this confusion will have to move quickly. Near-term decisions will influence not only how well organizations manage the current chaos, but more importantly, how they'll compete over the long haul. The survivors will be companies that, despite the complexity, confusion, and uncertainty of this marketplace, carefully assess the landscape and move forward.

Emerging Realities

The smoke is still rising, but the view's beginning to clear a bit. From our perspective, there are **three distinct strategic developments** emerging out of the clutter that will shape the direction of the new U.S. wealth management industry.

- 1) **Size no longer equals trust.** The days of investors finding comfort and confidence (and likely an advisor) in the stately bricks and historic mortar of the big Wall Street houses are over. The idea that size and history alone are enough to win the hearts, minds, and wallets of folks with money disappeared with Bear Stearns. Don't count on it re-emerging. The new reality is that multi-layered wealth managers are simply more complex, not more inspiring.

Already there is money in motion. Lots of it. Investors, many of whom are looking at a near halving of their net worth, are looking for better, or at least different, forms of advice. It's reasonable to expect the emergence of high-quality, high-touch advisory firms to fill the vacuum.

- 2) **Financial advisors are free agents.** Not surprisingly, there's a palpable, and growing, dissatisfaction among advisors with their tarnished brands. Surveys by reputable industry observers are already reporting up to two-thirds of wirehouse brokers would prefer some kind of independent setting. It's easy to infer that many, particularly the most productive, are noiselessly looking for some kind of soft-landing for their respective books of business.

The result, then, will be a dramatic rearrangement of sales professionals from the discredited big brands to boutiques and regionals. The environment is ripe for recruiting, particularly for the kind of good advisory talent that endures. The private bank model, certain regionals, and boutiques are likely to benefit. Look for acquisitions to accelerate.

- 3) **Investment quality and open architecture are essential to success.** The speed of the financial industry's gradual migration from proprietary products to open architecture investment platforms will increase algorithmically. In-house offerings and programs, already less viable, will wither as investors seek objectivity. New operations have been, and will continue to be structured with these ideals as key ingredients. They, and firms that emulate them, will have a distinct advantage.

Yet to be Determined

What hasn't come clear yet is Washington's role in Wall Street. We do know that since September the Feds have assumed a dramatically expanded role in financial markets. Policy makers have gone to great lengths to stabilize them, to support individual companies whose failure might pose systemic risks, and to prevent a deep economic downturn.

But we've no idea how well the government will work with the Street to develop effective regulatory and monetary policies, or what those responses may mean for the long-term health of the global capital market. There's high probability, though, for re-regulation of finance and many other sectors. Though little has occurred through this crisis to discredit the system of free-market capitalism, it's very likely government will have its hand in the industry to an extent few imagined possible. In the face of that unknown, stepping up due diligence and risk management efforts seems to make a lot of sense.

The next year or two will doubtlessly produce new wealth management leaders—and laggards—as reconstruction dynamics take shape. Those financial services companies that demonstrate the most flexibility and awareness will likely survive the crisis. Those whose leaders seize the extraordinary opportunities that arise during periods of uncertainty could very well prosper.