

THE \$100 TRILLION MARKET FAILURE

OREN KAPLAN, CO-FOUNDER SHARINGALPHA

Large-scale changes are afoot in the adviser and asset management industry. Oren Kaplan from SharingAlpha believes the key to the market's survival lies in greater transparency, which is exactly what the knowledge-sharing, fund rating platform he created with his brother aims to achieve.

Over \$100 trillion is managed globally by active managers. Most of the assets flow to managers that have performed well in the past and outflow from those that have underperformed. That said, research has proven time and time again that past performance isn't a reliable indicator of future results. This is a reality, not just a disclaimer at the bottom of every fact sheet. The question is why investors behave this way and how the current market structure has led to this market failure.

OREN KAPLAN

Oren Kaplan has over 20 years' experience in senior management positions in the financial industry. He is the author of the best seller "Psycho-Finance: The New Psychological Approach to Investments". He is currently the CEO and co-founder of SharingAlpha, often referred to as "TripAdvisor meets Morningstar" and is a partner at an asset management firm that currently has \$38 billion under management. He holds a BSc in Economics from the University of London and an MBA from Tel-Aviv University.



+ DEPENDING ON THE PAST

Part of the problem is that most investors don't manage their own savings, relying instead on financial advisers. Naturally, those advisers need to have solid reasoning behind the selections they make on behalf of their clients. Investing other people's money into a fund that has performed terribly or has yet to have generated a significant track record would leave the adviser highly exposed if the investment went south. In order to avoid such a situation, most advisers prefer to play it safe and rely on some kind of past performance analysis. This despite the proof that suggests such a strategy will not add value to the end investor.

Furthermore, an investor that is faced with the dilemma of selecting an adviser that has no proven track record of adding value to his or her clients is left in the dark as to how best to choose someone suitable. An objective measurement of adviser success is unavailable and as a result adviser selection is dependent solely on factors such as service and presentation capabilities rather than hard and indisputable numbers.

+ CHANGING REGULATORY LANDSCAPE

Meanwhile, regulatory changes are also contributing to the industry's transformation. Historically, advisers were allowed to receive kickbacks from fund managers and clients were happy to receive this "free" advice against a backdrop of relatively passive regulatory oversight. This serious conflict of interest definitely didn't work in the best interests of investors. Post the 2008 financial crisis, regulators have taken a more active approach to policing the industry and have introduced changes that increase the financial pressure on advisers, who now need to ask their clients to pay them for advice.

This has resulted in many advisers moving away from active funds that could no longer pay them sufficiently, to passive alternatives that require less research. More importantly, passive investments are often seen as a safer bet by advisers. Rather than having to later explain why they chose a manager that underperformed the benchmark they can simply, and cheaply, buy the benchmark itself.

On the back of the above changes, we are currently witnessing one of the greatest movements of assets ever seen in the asset management industry towards cheaper solutions like exchange-traded funds (ETFs) and robo-advisers. Could this spell the beginning of the end for active managers and human advisers?

+ GREATER TRANSPARENCY REQUIRED: ENTER SHARINGALPHA

In my opinion, the only way this market can survive is if further transparency is introduced. To my mind, this can best be achieved by the use of a platform that enables advisers to select winning managers in advance and offers investors simple and objective tools to select advisers with a proven track record of adding true value to investors.

Since I couldn't find such a platform, I decided to take the initiative and create one. With the support of my brother who has been writing computer code for over 30 years, we turned this idea into reality. We call it SharingAlpha and that's exactly what it aims to achieve.

+ IT'S TIME FOR A RATING PLATFORM

The SharingAlpha platform gathers the views of thousands of advisers and measures their success rate, essentially using "wisdom of the crowds", to help investors select the best advisers, and advisers to prove their track records.

The greatest advantage afforded by such a large group of professionals using a user-generated fund rating system platform is the potential to grow to scale more rapidly and effectively. This is done by moving from the current rating model where advisers work in silos to a more centralized approach in which their views are shared on a dedicated platform.

This change can be compared to the change seen in the use of encyclopedias. Traditional encyclopedias were previously created through costly, complex, difficult-to-manage supply chains of academic experts, writers, and editors. Using a platform model, Wikipedia has built an information source comparable to Britannica in quality and scope by leveraging a community of external contributors to grow and police the content.

+ ADAPTING TO CHANGE IS ESSENTIAL

The successful introduction of the platform model to the asset management industry creates plenty of opportunities for those members of this community that do adapt to the change. On the other hand, investment advisers that fail to do so will risk falling behind the curve. The sharp decline in valuation of the NYC taxi medallion (from over \$1.2 million in 2013 to less than \$300,000 today thanks to the rise of ride-share firms like Uber) should serve as a warning sign to firms and individuals that make their living from selecting funds as to how quickly technology can disrupt traditional business models.

Unless such firms and individuals are able to show hard and fast evidence of their actual added value, it is questionable as to how long they will be able to maintain current “valuations”.