ECHELON PARTNERS
Visionary Advice. Execution Excellence.

NEWS RELEASE

SCHWAB'S PURCHASE OF WINDHAVEN MADE ITS ASSET GROWTH SOAR – AND RIA ASSETS MAY BE THE AFTERBURNERS

The Boston-based phenom has gathered assets mightily in good markets but may do even better in bad ones.

August 15, 2011
Originally Published By Brooke Southall, RIABiz

Although Windhaven has been owned by Charles Schwab & Co. for only nine months, the firm's post-deal growth may be exceeding the already lofty expectations for the acquisition.

Assets in the Boston-based manager of exchange traded funds, formerly Windward, currently stand at about $6.6 billion, up 46% from about $4.5 billion when the deal closed.

The princely sum of $150 million in cash and stock that Schwab paid Windhaven clearly set a high bar for continued fast growth, analysts say. See: A look inside Schwab's big deal with a small asset manager.

The deal, which closed on Nov. 10, appears to be on track for the San Francisco-based financial giant.

Validation

"We're thankful to have this kind of growth. It validates what we believed all along – that we appeal to all kinds of investors whether they be advisors or retail clients," says Bryan Olson, president of Windhaven.

The numbers speak for themselves on the growth of the hedge fund-mimicking asset manager, according to **Dan Seivert**, CEO of **ECHELON Partners**, an investment bank for advisory companies in Manhattan Beach, Calif.

"They've grown close to 50% in less than a year so I think that's exceptional growth. I doubt Schwab bought it with the expectation it would grow [so quickly]."

Seivert added, however, "I don't think one year determines the long-year growth path."

Dan Seivert: They've grown close to 50% in less than a year so I think that's exceptional growth. I doubt Schwab bought it with the expectation it would grow [so quickly]

Olson estimates that Windhaven's assets break down at 50% held by retail clients; 30% held by clients of financial advisors; and 20% by endowments, foundations and pension plans.

Windhaven's fees are more reasonable than a hedge fund but not cheap: .95% on the first $500,000, .9% on the second $500,000 and .8% on assets over $1 million.

Retail-side growth

The secret to Windhaven's success has been the approach of its founder and CEO, Steve Cucchiaro, who scrutinizes markets and industries, then uses mostly exchange traded funds to allocate client funds across 40 asset classes and investment styles. The adept picks and hyper-diversification have made his portfolios' returns perform stand out – particularly in down markets (see performance results below).

Much of the growth has come from the retail side of the business. Formerly, Schwab made Windhaven available on a regional basis and its national rollout in Schwab branches has produced impressive results.

Cucchiaro suggests in an e-mail that the growth has come at price for him personally.

"I've traveled more miles this year than in the previous three years combined, but it's been very gratifying to see the interest/enthusiasm in what we do just explode… Schwab has been a phenomenal partner in helping us achieve greater scale/reach."

Slowing Windhaven's asset gathering through RIAs is the fact that new advisors have a longer due-diligence cycle, according to Olson. Twelve new advisors signed on to use Windhaven but so far they've produced a low asset flow.

"We expect to see the flows increase," he adds.

Pedal to the metal

The deal seems to be working the way a Harvard Business School professor would draw it up on the whiteboard.

"You have a distributor hooking up with an investment product manufacturer. You want to see that the vertical integration is working and the distributor relationships are coming to bear," Seivert says.

Indeed, the lion's share of new Windhaven assets are coming in from Schwab clients rather than existing Windhaven clients, according to Schwab spokeswoman Alison Wertheim.

That asset gathering could accelerate further when Windhaven and RIAs start to click – a likely prospect due to the portfolios' appeal to advisors of all sizes, according to Olson. Big advisors tend to use it as a way to have an "uncorrelated sleeve" of investments as part of a larger portfolio. Smaller advisors tend to see it as a way to achieve a broad diversification, he says.

Conflict

Yet some RIAs perceive Windhaven as a competitor for assets that come in through the company's branches.

"The referrals are all going to Windhaven right now," says Roger Hewins, president of San Mateo, Calif.-based Hewins Financial Advisors, which manages about $2.5 billion of assets. "We had one that was supposed to come to us and they went to Windhaven after they had already met with us."

Rick Keller, founder of First Foundation Advisors of Irvine, Calif., says that his firm also experienced a slowdown in referrals from Schwab but doesn't believe that Windhaven is the main cause.

"We tried to pinpoint it; we weren't able to trace it back to Windhaven," he says.

Instead, Keller attributes the slowdown to turnover at the Schwab branches and how the new employees viewed his firm.

"They weren't all familiar with us and there was a feeling that clients didn't need financial planning."

First Foundation manages about $1.7 billion.

Olson says that Schwab has taken steps to minimize conflict between RIAs and Windhaven. For one thing, Windhaven was removed from the Schwab Advisor Network, the company's referral program for RIAs. Previously Windhaven sat right alongside them on the list. It's now on Schwab's list of managed accounts.

In addition, Windhaven has stopped taking on clients directly. "We no longer take individual clients. We no longer compete….That was part of the Schwab rationale," Olson says.

Safety dance

It still ends up being competitive because clients are looking for a way to invest safely in tough markets and Windhaven has effectively marketed itself that way, Hewins says.

The ETF manager had good returns in 2008. That one good year has made its three-year returns look good even though it has underperformed the S&P 500 since then, he explains.

"People understand that you don't need to make as much on the upside [when you lose less in down markets]," Olson says.

When the markets tanked in 2008, Windhaven's Diversified Growth Portfolio was down only 15.4% compared to 22.1% for the Growth Benchmark. Its Diversified Aggressive Portfolio lost 20.7% in 2008 versus 37% for the S&P 500.

But in the more favorable conditions of 2010, Diversified Aggressive was up only 9.1% compared to 15% for the S&P 500 and Diversified Growth was up just 8% compared to 12.1% for the Growth Benchmark.

Hewins believes that his portfolios will be more competitive with Windhaven when people begin to have greater faith in the markets again.

And Windhaven may outperform in a down market. "I hate to hope for that" Olson says. (This interview occurred before the market headed down.)

Efficient vehicle

So how much of the success of Windhaven can be attributed to the fact that it uses the perennially popular ETFs?

"We see a lot of the ETF [managers] taking advantage of the popularity of ETFs. ETFs happen to be the most efficient vehicle to access," Olson says. "[But] we don't think of ourselves foremost as an ETF manager – more of a global allocation manager."

Yet there's no doubt that many companies are finding ETF management a powerful way to manage money.

Jud Bergman, CEO and chairman of Envestnet, says that PMC's Portfolio Solutions have been a big success for his company.

"We've seen real growth in our managed ETF program – almost $2 billion of net flows over the last couple years."

Daniel Seivert
Managing Director
dseivert@echelon-group.com

Tyler Resh
Principal
tresh@echelon-group.com