

The evolution of Vanguard Advisor's Alpha[®]

From portfolios to people

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Agenda

Evolution of advisor's alpha

Current influences, lasting impressions

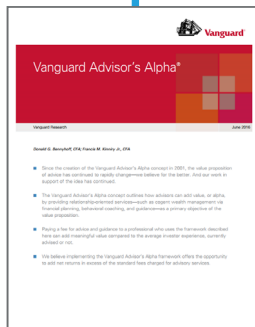
Evolution of advisory offerings

Evolution of the advisor

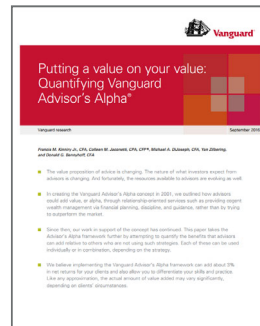
The evolution of
advisor's alpha

Advisor's alpha timeline

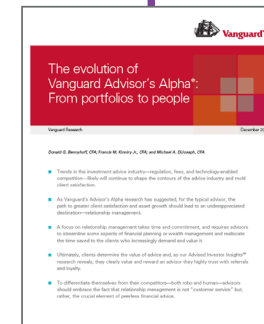
Advisor's alpha
2001



2014
Quantifying
advisor's alpha



Evolution of
advisor's alpha
2018



Vanguard Advisor's Alpha

The Vanguard Advisor's Alpha concept outlines how advisors can reframe their value proposition by *prioritizing client-centric, relationship-oriented services*, rather than solely portfolio management

Quantification of Vanguard Advisor's Alpha

Vanguard Advisor's Alpha strategy	Value-add relative to "average" client experience (in basis points of return)
Suitable asset allocation using broadly diversified funds/ETFs	>0*
Cost-effective implementation (expense ratios)	40
Rebalancing	35
Asset location	0 to 75
Spending strategy (withdrawal order)	0 to 110
Total-return versus income investing	>0*
Behavioral coaching	150
Potential value added	"About 3%"

Source: Francis M. Kinniry Jr., Colleen M. Jaconetti, Michael A. DiJoseph, Yan Zilbering, and Donald G. Bennyhoff, 2016. *Putting a value on your value: Quantifying Vanguard Advisor's Alpha*. Valley Forge, Pa.: The Vanguard Group.

* Return value-add for numbers one and six was deemed significant but too unique for each investor to quantify. Also, for "Potential value added," we did not sum the values because there can be interactions between the strategies. Bps = basis points.

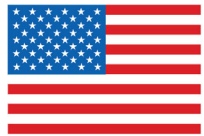
Note: "About 3%" means 3 percentage points of additional net return over an unspecified period of time.

Current influences, lasting impressions

Regulations, fees, and technology

Regulatory environment—Global, not local, considerations

- Emphasis on transparency and disclosure
- Genie is out of the bottle: “Great awakening” of investors
- Global phenomenon



United States
DOL fiduciary rule



European Union
Markets in Financial
Instruments Directive II



Australia
Future of
Financial Advice



Canada
Client Relationship
Model I/II

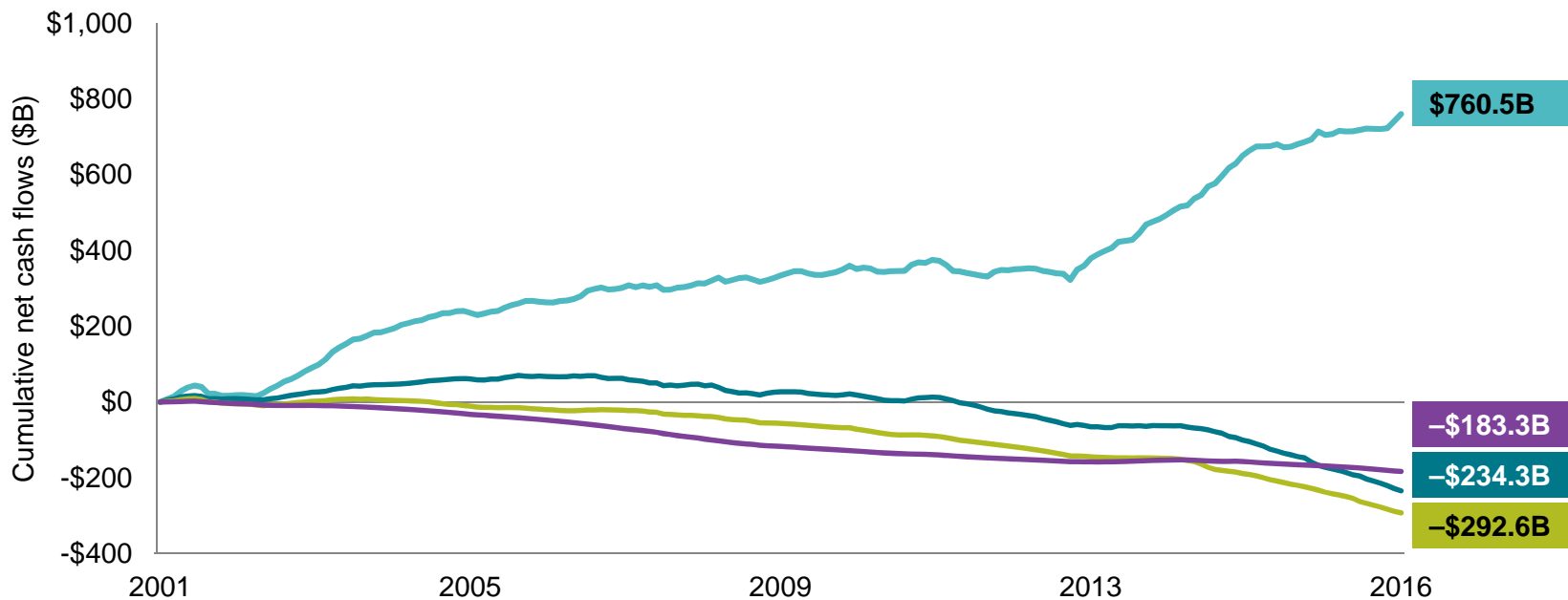


United Kingdom
Retail Distribution Review

Investment management fees: Investors and advisors are voting with their feet

High-cost funds are under pressure

Cumulative equity fund net cash flows by cost quartiles



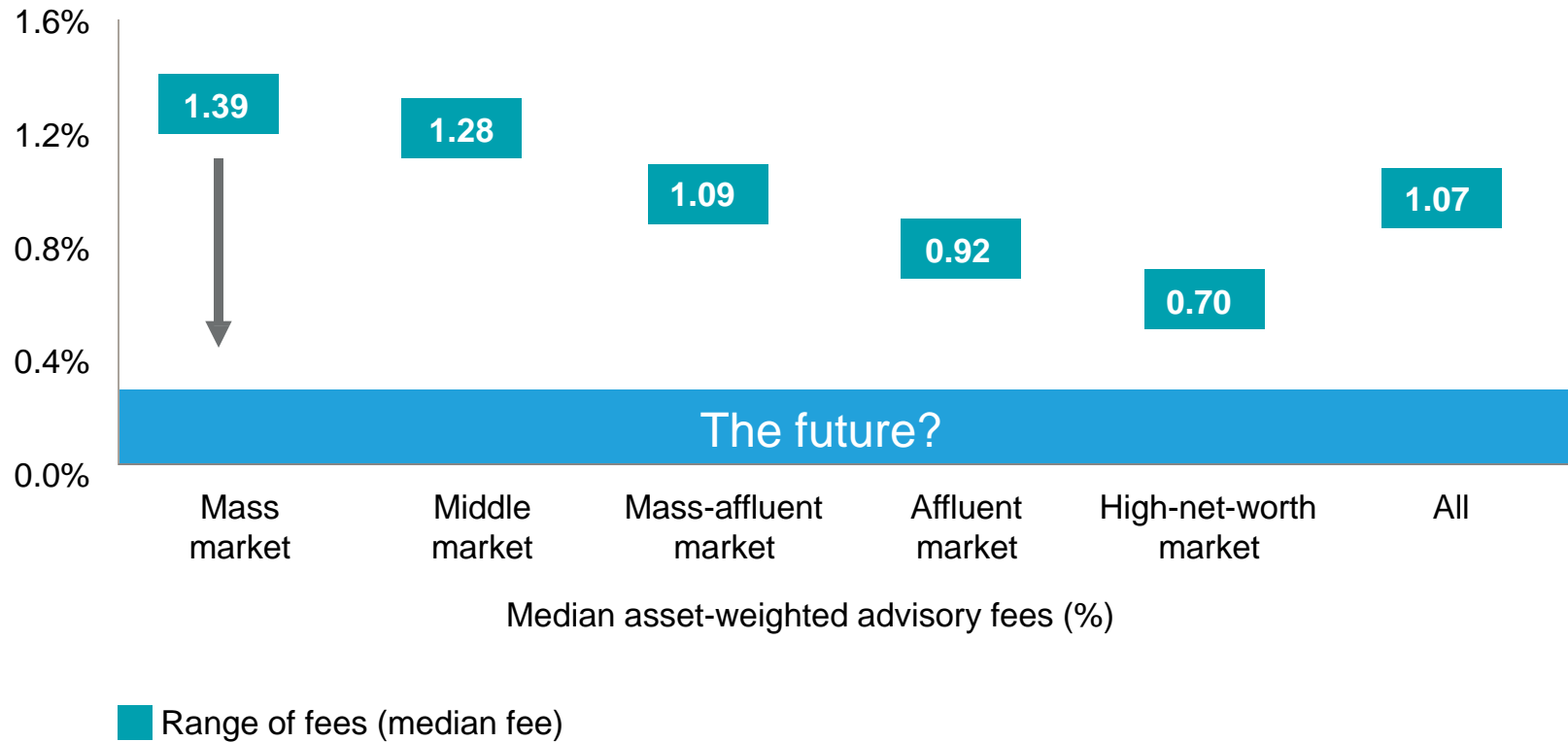
All U.S. equity funds and ETFs, cumulative net cash flow

— Quartile 1: 0.40% — Quartile 2: 0.90% — Quartile 3: 1.17% — Quartile 4: 1.74%

Source: Vanguard calculations, based on data from Morningstar, Inc.

Notes: Expense-ratio quartiles were calculated annually. Equity funds represented by Morningstar U.S. equity category. Each quartile represents 2016 asset-weighted average expense ratios, determined by multiplying annual expense ratios by year-end assets under management and dividing by the aggregate assets in each quartile. Data are as of December 31, 2016.

Advice fees: The next shoe to drop?



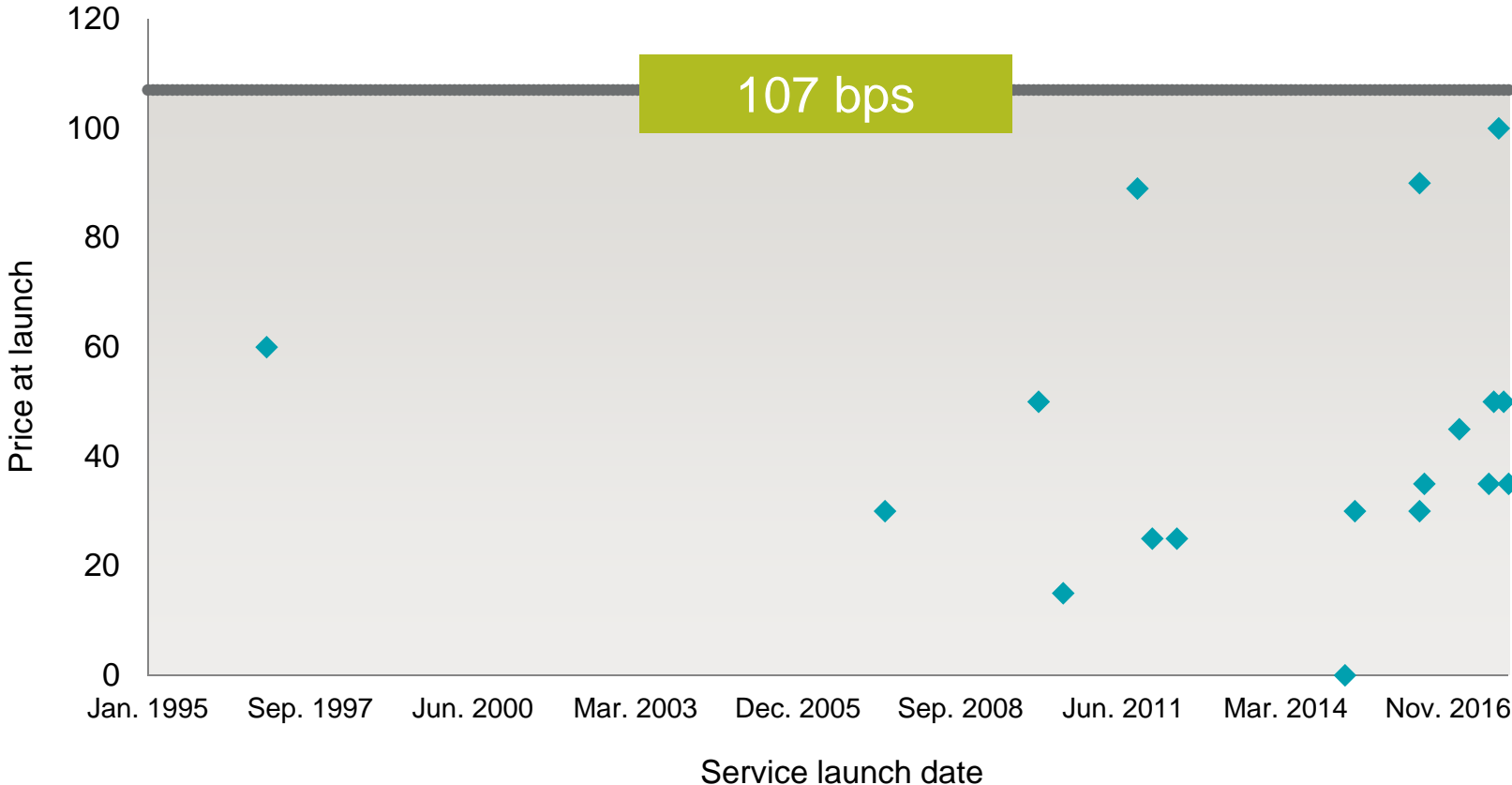
Source: Vanguard calculations, using data from Cerulli.

Notes: Vanguard calculated the 107 bps asset-weighted average advice fee based on data through December 31, 2015, provided by Cerulli in its U.S. Advisors Metrics 2016 report. Advisory fees are reported by account size, rather than core market. For calculation purposes, we matched each core market to the closest account size. Mass market is \$100,000; middle market is \$300,000; mass-affluent market is the average of \$750,000 and \$1.5 million; affluent market is the average of \$1.5 million and \$5 million; high-net-worth market is \$10 million.

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The march of tech-enabled advice

More in number, lower in price



Source: Vanguard calculations using data from Cerulli and the advice firms' websites.
Note: Vanguard calculated the 107 bps asset-weighted average advice fee based on data through December 31, 2015, provided by Cerulli in its U.S. Advisors Metrics 2016 report.

But advanced skills remain uniquely human

BASIC ●○○	REPETITIVE ●●○	ADVANCED ●●●
<ul style="list-style-type: none">GrowingHarvestingDiggingMoving objectsRecording information	<ul style="list-style-type: none">InspectingMonitoringAssemblingGetting informationProcessing informationScheduling	<ul style="list-style-type: none">Maintaining relationshipsInteracting with the publicPersuading outcomesTrainingDeveloping teamsApplying knowledgeStrategizingThinking creativelySolving problemsAssisting/Caring for othersJudging qualityConducting complex physical movements

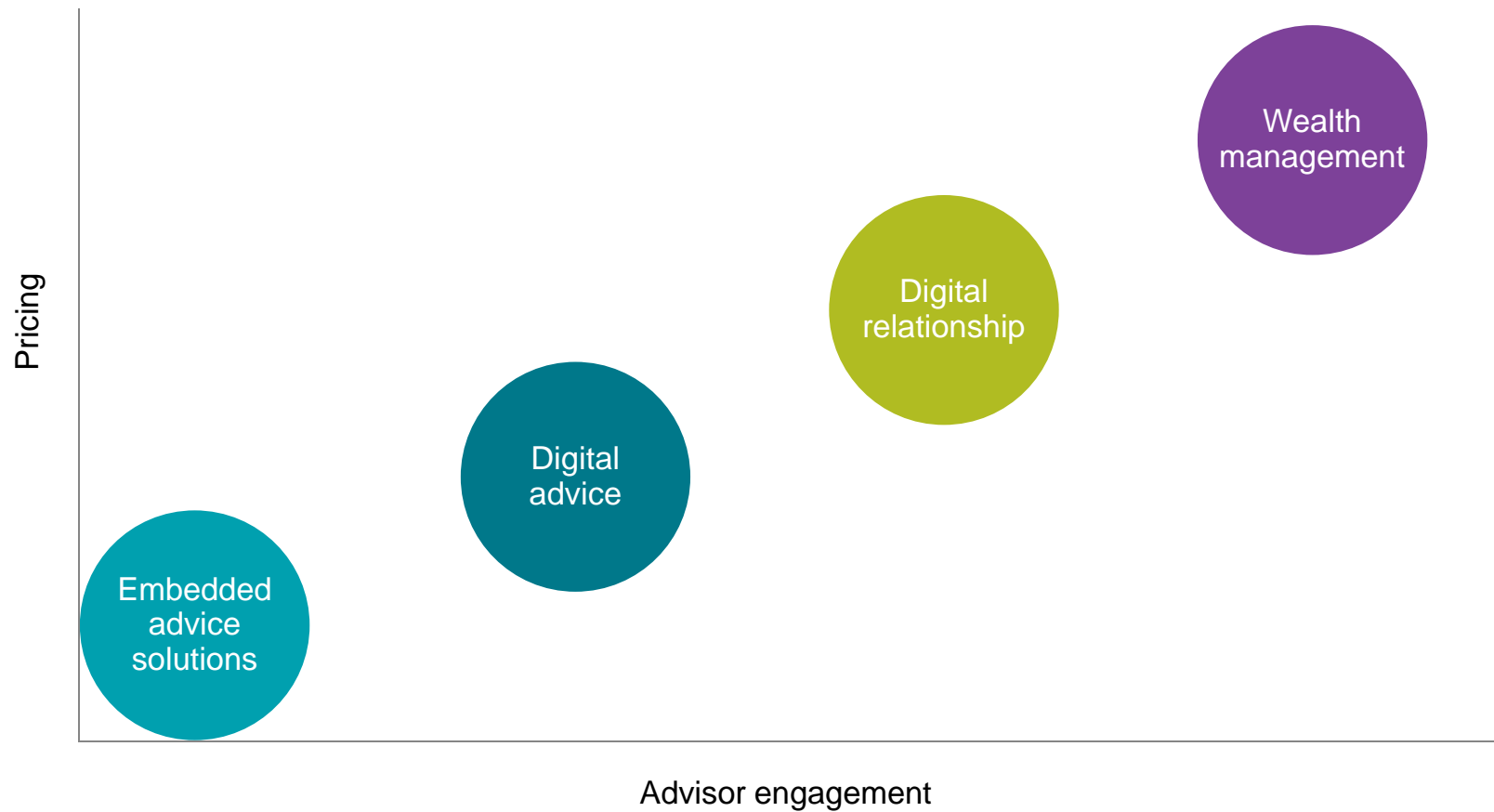
Source: Vanguard.

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Evolution of the
advisory offerings

Efficient frontier for advice services

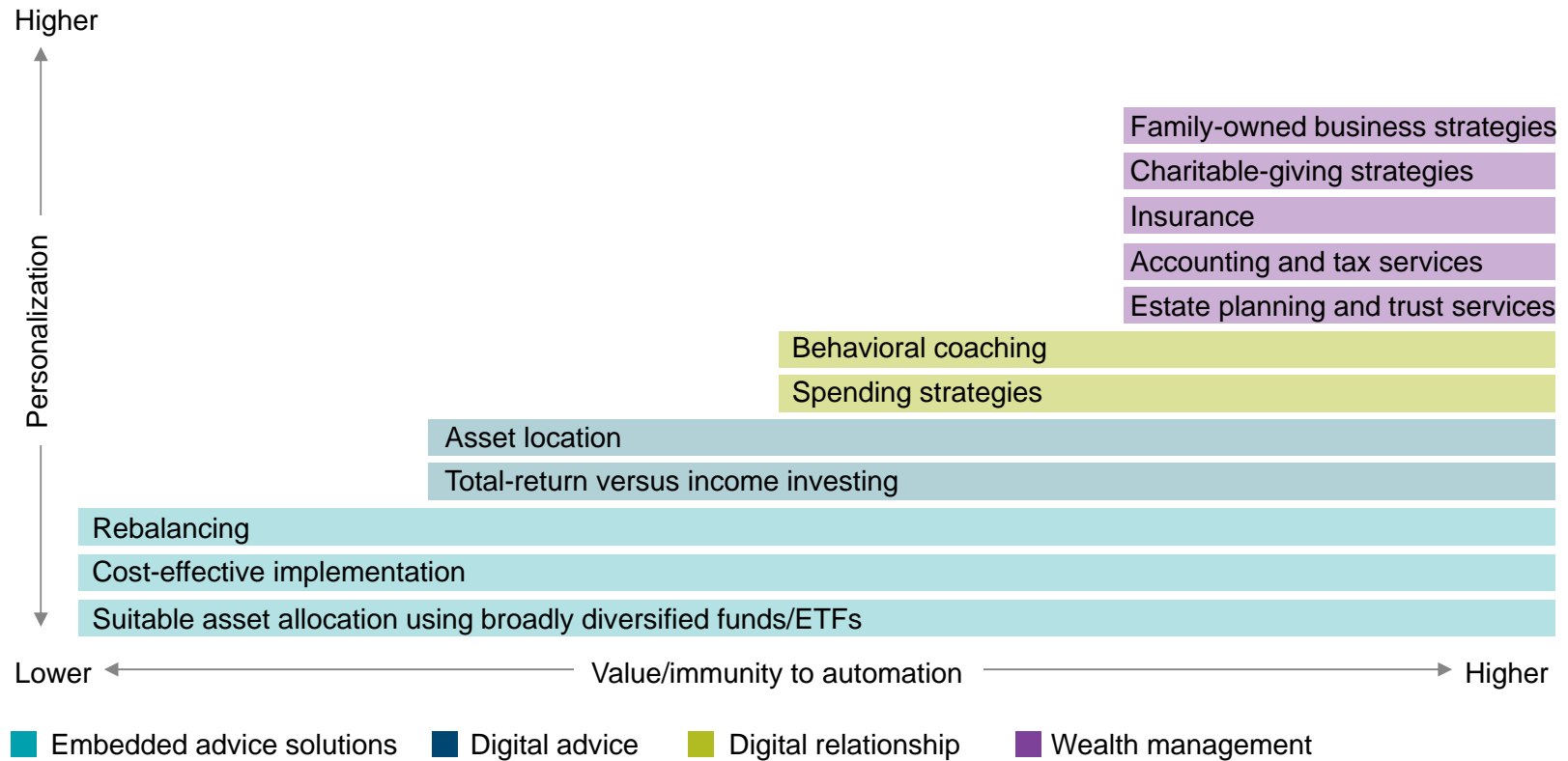
Firms should be indifferent to advice offering as long as price and services are appropriately aligned



Source: Vanguard.

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Not all advice can be automated

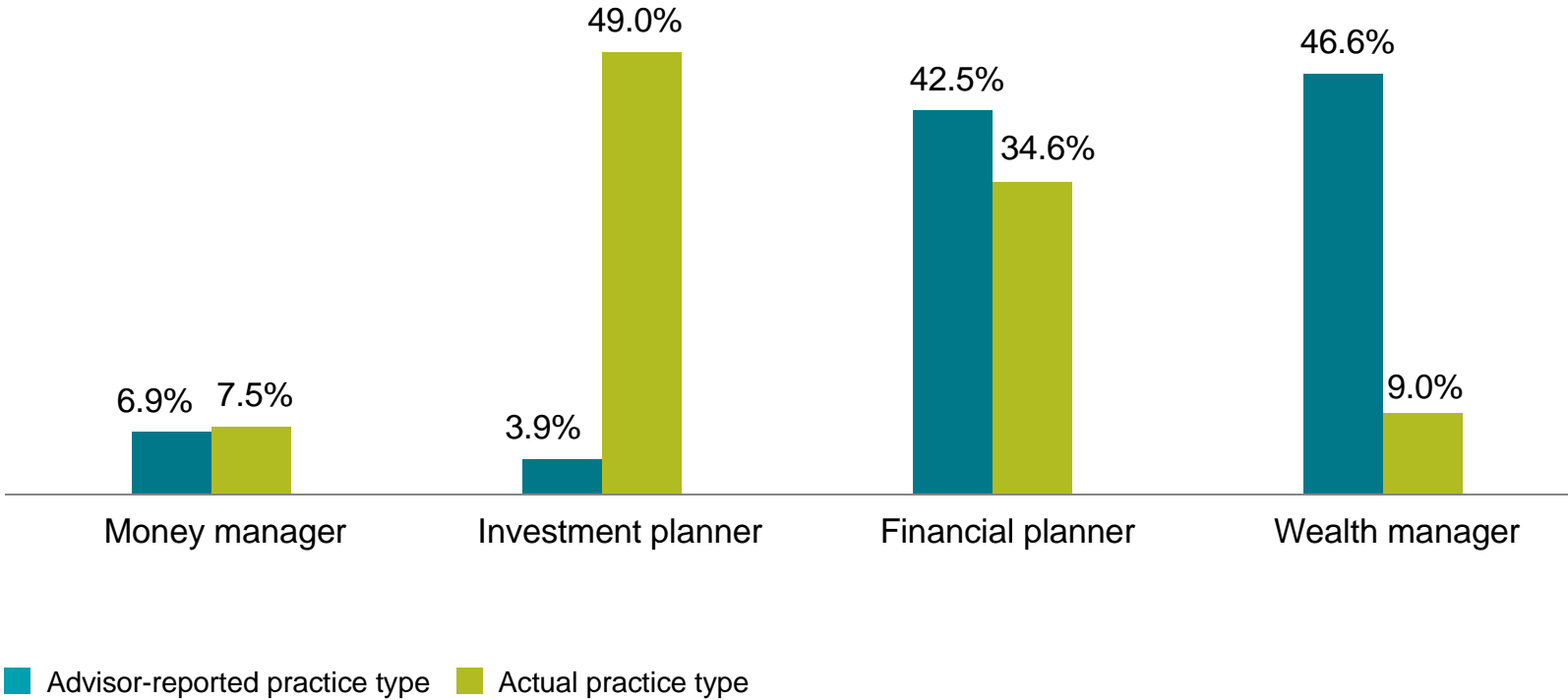


Source: Vanguard.

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Know thyself

Advisor perceived versus actual practice type



Source: Cerulli Associates, 2015. *The Cerulli report: Advisor metrics 2015*. Boston, Mass.: Cerulli Associates.
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Evolution of the advisor

Evolution of the advisor

Advisor's alpha
key takeaway:

***Focus on relationship
management, not
portfolio management***

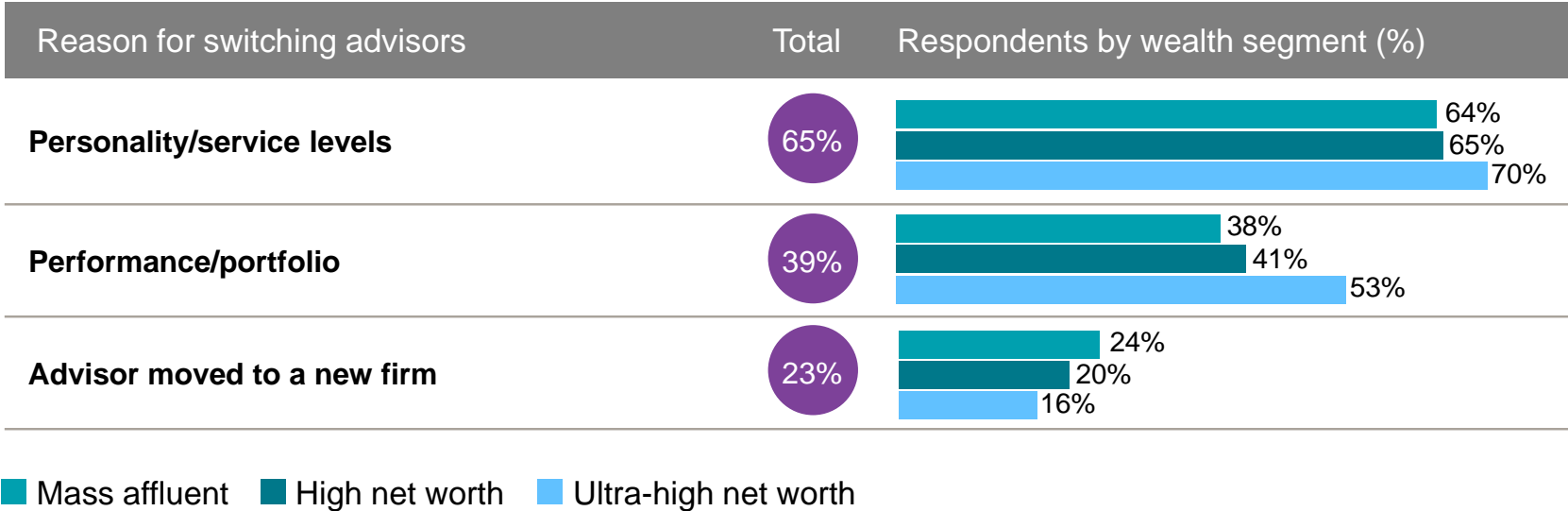
Need to use our
knowledge and
experience **where it
can do the most good**

- Behavioral coaching
- Relationship management

An advisor should
be an **investment
professional, not a
professional investor**

Why relationship management matters

Clients are evaluating their advisor’s performance more than their portfolios’

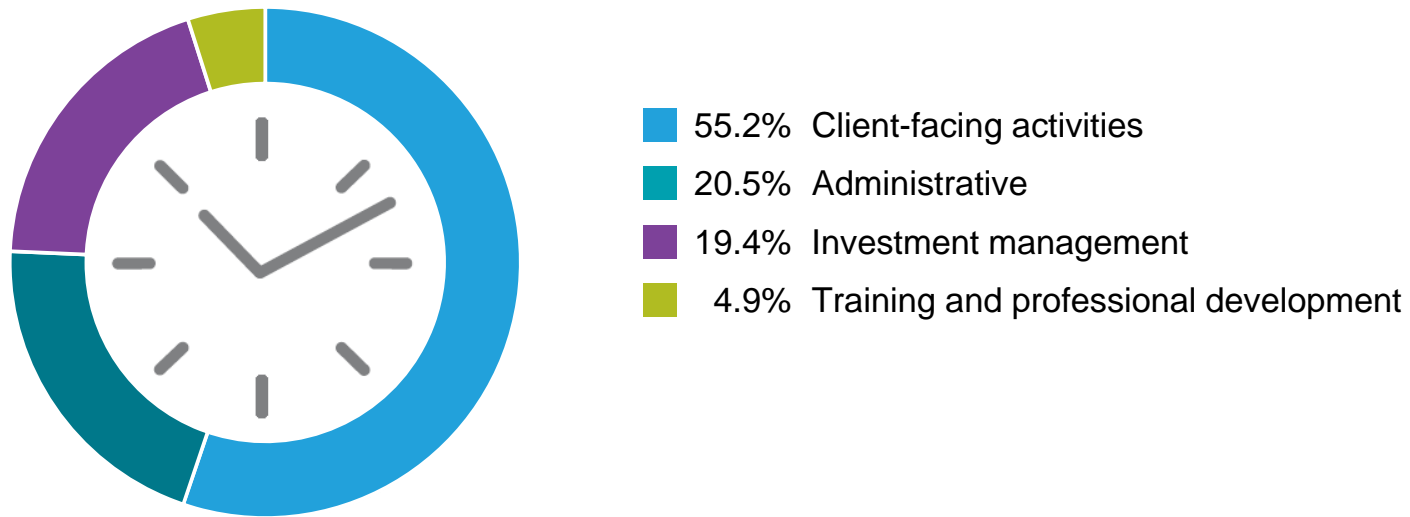


Sources: Vanguard and Chadwick Martin Bailey.
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Time is an asset to be invested, not spent

Technology-enabled efficiencies could provide **more time for clients and trust-building**

Advisor time allocation by activity



The return on time

<p>Relationship management should not be confused with “customer service” but be considered business development or prospecting</p>	<p>Should be a key driver of client satisfaction and referrals</p>	<p>More time should equate to more “Hey, how are you doing?” calls</p>
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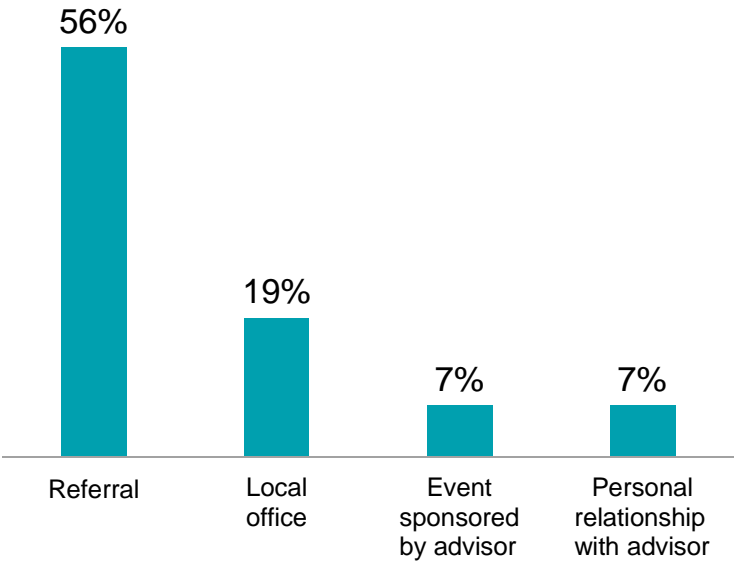
What is your return on time?

<p>Trust</p>	<p>Loyalty</p>	<p>Confidence</p>	<p>Referrals</p>
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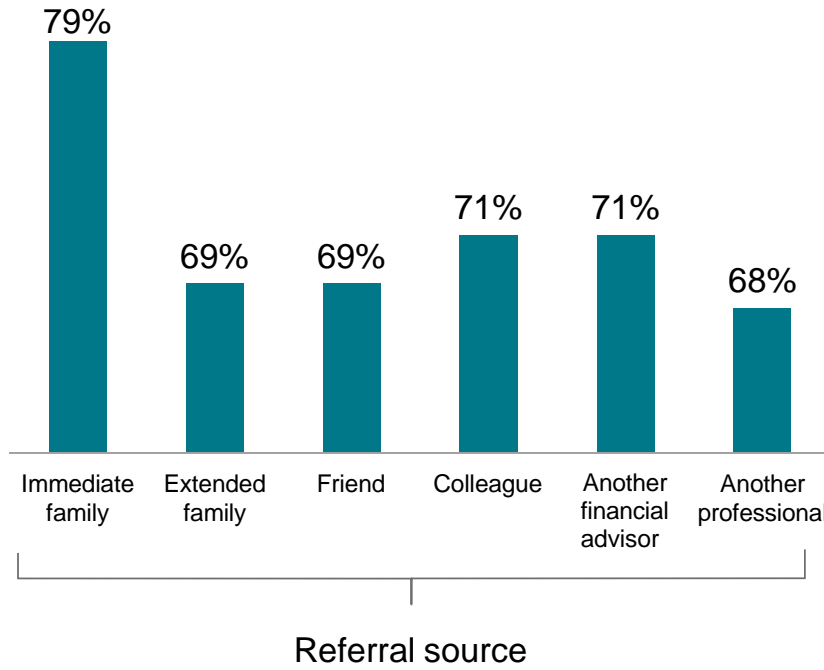
Advised Investor Insights™

Relationship management is business development

How current advisor was found



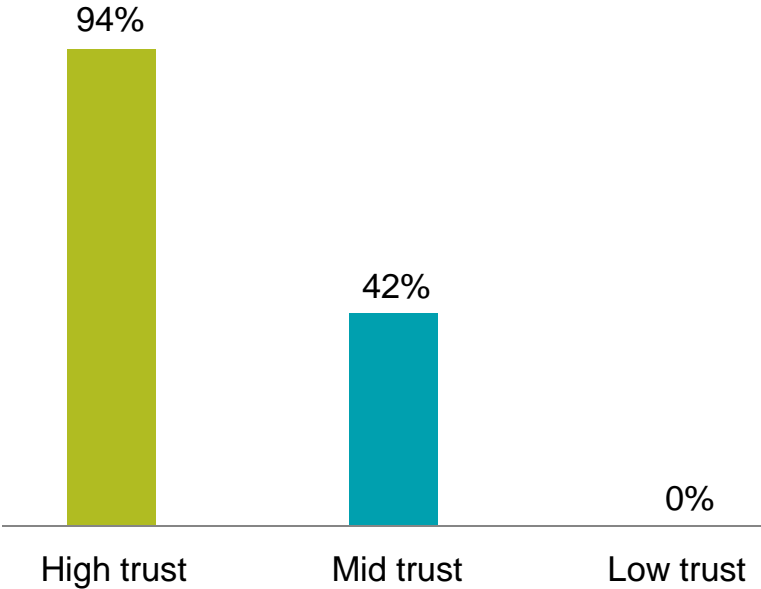
Likelihood of selecting an advisor



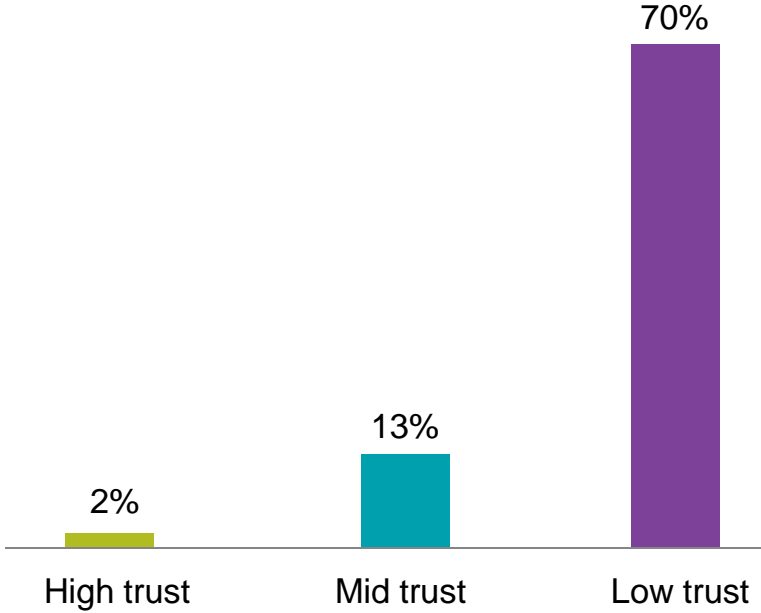
Sources: Vanguard and Chadwick Martin Bailey.
Notes: Proprietary research conducted by Vanguard and Chadwick Martin Bailey, a market research and consulting firm. Vanguard's *Advised investor insights* is an ongoing, proprietary research series that provides actionable insights on investor behavior.
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Trust motivates referrals and drives asset retention

Extremely likely or likely to **offer referral**



Extremely likely or likely to **switch advisors**



Sources: Vanguard and Chadwick Martin Bailey.
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Advised investor insights: Trust is complicated

Components of trust



Sources: Vanguard and Chadwick Martin Bailey.
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What does a financial advisor have to deliver to be trusted?

KNOWLEDGE/ PERFORMANCE

“Knowledge of various investments, sound recommendations, **demonstrated performance** over time, good communication skills, [and] being available to clients.”

—*High net worth, male*

HONESTY/ INTEGRITY

“Totally transparent honesty in all discussions, evidence of **strong moral character** both in business and personal life, clear and concise explanation of the financial plan, and the pathway to achieve the defined end goals.”

—*Mass affluent, male*

MAKE ME FEEL VALUED

“To be trusted, he must first **respect us** for who we are, understand that our success turns into his success, and keep close in communications whether times are good or bad. Also, face-to-face contacts go a long way in maintaining that trust.”

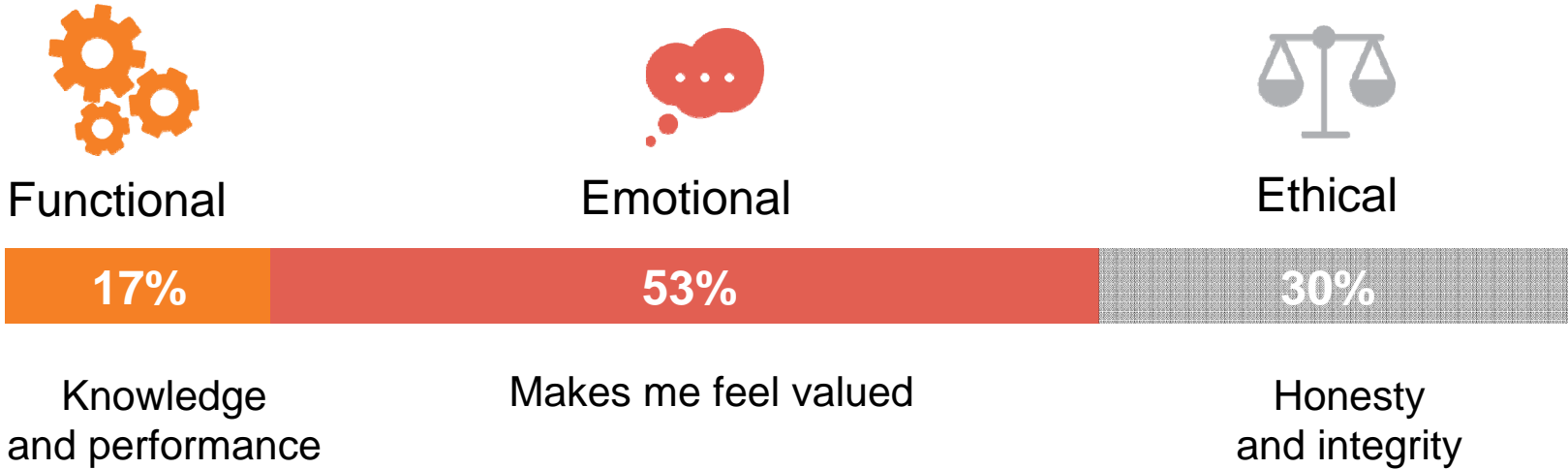
—*Mass affluent, female*

Sources: Vanguard and Chadwick Martin Bailey.

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Advised investor insights: Trust is complicated

Components of trust



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Conclusion

What you can do?

- Concentrate on lowering investment management costs
- Spend more time building trust with clients than building portfolios
- Leverage technology, teams, and managed portfolio solutions to gain time to invest in your client relationships
- Make clients feel valued and cared for, like people not portfolios
- Practice emotional intelligence

There's no “one way” to do things right as long as you're focused on earning high trust from your clients every day.

Why should you do it? Good for your business—Good for your clients

The advisor's alpha flywheel



Important information

For more information about Vanguard funds or ETF Shares, contact your financial advisor to obtain a prospectus or, if available, a summary prospectus. Investment objectives, risks, charges, expenses, and other important information are contained in the prospectus; read and consider it carefully before investing.

Vanguard ETF Shares are not redeemable with the issuing Fund other than in very large aggregations worth millions of dollars. Instead, investors must buy and sell Vanguard ETF Shares in the secondary market and hold those shares in a brokerage account. In doing so, the investor may incur brokerage commissions and may pay more than net asset value when buying and receive less than net asset value when selling.

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Investments in bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments. High-yield bonds generally have medium- and lower-range credit-quality ratings and are therefore subject to a higher level of credit risk than bonds with higher credit-quality ratings. Although the income from a municipal bond fund is exempt from federal tax, you may owe taxes on any capital gains realized through the fund's trading or through your own redemption of shares. For some investors, a portion of the fund's income may be subject to state and local taxes, as well as to the federal Alternative Minimum Tax. Diversification does not ensure a profit or protect against a loss.

Investments in Target Retirement Funds are subject to the risks of their underlying funds. The year in the Fund name refers to the approximate year (the target date) when an investor in the Fund would retire and leave the workforce. The Fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in the Target Retirement Fund is not guaranteed at any time, including on or after the target date.

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