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Washington Takes On Wall Street

KEEPING THE WEALTH IN WASHINGTON

AS WALL STREET COLLAPSES, INVESTORS SEEK SAFER HARBORS CLOSER TO HOME FOR THEIR WEALTH.

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Seattle has long fancied itself a world business capital, especially when it comes to computer software, coffee or internet retailing. A lot of local people certainly made a lot of money from national—even international—success in those and other businesses. "If ever there was a community that benefitted from the economy" over the last 30 years, Seattle was the place, says David Lewis, chairman and chief executive of Seattle-based First Washington Corp., which manages $750 million in client wealth. ¶ But when it came to managing the money its entrepreneurs, investors and business executives made, says Lewis, "We've largely been a branch office." ¶ As fast as the money was made, much of it was sent off to Wall Street firms. At the height of Seattle's economic boom, some big national firms opened Seattle offices to scoop up even more of the money believed to be lying around. ¶ "You don't have a lot of the money actually managed here," says Bill Whitlow, senior vice president and senior portfolio manager at Davidson Investment Advisors in Seattle. "You don't have a lot of large money managers here."

That era may be coming to an end. Wall Street is now more vulnerable than at any time in recent decades. The past year's financial meltdown has evaporated billions of dollars in assets from the smallest individual retirement accounts to the biggest endowments. Century-old firms have been shut or forced to sell to banks at huge discounts. Local investors burned and chastened by sinking money into exotic investments marketed by East Coast firms are retreating to plain-vanilla investments they understand, and to close-to-home managers.

Old money, the inheritors of which have tended to keep their funds in the big New York firms that their parents and grandparents frequented, is now beginning to look around.

"We are getting a lot more calls from second- and third-generation wealth that tended to stick to the big companies in the past," says Jon Jones, one of the founders of Brighton Jones, a Seattle-based wealth management firm that manages about $1.5 billion in client assets.

A perceived lack of communication during the meltdown between the big Wall Street firms and their clients may have contributed to investors seeking safer harbors for their money closer to home. Amid the confusion of the meltdown on Wall Street, Jones says his employees were in constant contact with their clients. By contrast, with many Wall Street firms facing possible liquidation, their brokers didn't always do a good job of returning investor calls.

The physical proximity of local firms helped calm some individuals during the crisis. Investors "just like to go around the corner and talk to the person who's got my money and make sure it's still there and they haven't shipped it off to Bernie [Madoff]," says Richard Lindsay, senior vice president of the life and annuities division at Bellevue-based Symetra Financial Corp.

"There are a lot of good brokers at all size firms that have high client touch," says Mark McClure, president of Ragen MacKenzie, a regional brokerage now owned by Wells Fargo, "but regional firms are also very good at that. I think that is going to play very well going forward."

STEALING FROM THE STREET

Taking market share from the Wall Street firms is not going to be easy. For one thing, in terms of performance, clients of local firms got hit just as severely as national firms. "The clients know that," says Richard McCormick, president of McCormick Capital Management, a Seattle firm that operates the Elite mutual-funds group. "There was no place to hide."

Assets under management by 330 Washington state money managers plunged to $292 billion in the first quarter of 2009, down $79 billion, or 21 percent, from the year before, largely reflecting the market's decline, according to RH Financial, a Covington-based financial services executive recruiting firm that compiles a yearly ranking of the largest money management companies in Washington. "Investors are in a frozen state and there may be no clear 'winners' to flee to," says Roger Hendrix, president and chief executive of the company.

"This financial crisis has been so well publicized, clients don't actually blame the broker or the adviser," adds Ragen MacKenzie's McClure. Unless they were heavy in cash or gold, the downturn "clobbered every [asset] class, and we were right along with that."

"You've already got a portfolio somewhere, you've got a broker, an adviser or a trust officer or somebody you have a relationship with," Whitlow says. "Unless they've burned you, you're probably going to stick with that person." McCormick adds that while he received lots of calls from clients who had accounts at other firms prominently mentioned in headlines, almost all of them kept their money where it was. (There was one exception to this rule in a local company with very big—and ultimately fatal—problems: Washington Mutual.)

Richard Sias, who holds the Gary P. Brinson Chair of Investment Management at Washington State University, thinks both local and national wealth managers might find themselves with more clients. "People who were handling their own money and may have felt comfortable about how their retirement/college savings were going are likely to feel much less confident now and seek advice," he says.

Even if clients do come home, they won't be bringing as much with them. Says Sias, "There are simply fewer assets to manage now. From the money management firm's perspective, assets under management [and associated fees] have declined sharply. Thus, even with an influx of new clients, firms are unlikely to see increased profitability."

For all the scary stories, customer inertia is also very hard to overcome. "Investors are in a frozen state and there may be no clear 'winners' to flee to," says Roger Hendrix, president and chief executive of RH Financial.

THE RECRUITING RUSH

But local firms have a shortcut to winning new business: Recruit the brokers and money managers, who in turn will bring their wealthy customers with them.

The big national and global firms—insiders call them the "wire houses"—have had their financial performance and their reputations torched by the market's meltdown. Many are undergoing challenging mergers. Soon after Bank of America acquired Merrill Lynch, it angered brokers by slashing their share of the commissions they bring. Morgan Stanley has treated the employees of Smith Barney, the troubled brokerage it acquired, as a second-class citizens. Brokers at many of these national firms are now looking for new homes.

> **"At the end of the day, you need a place you can go and get the right advice." — David Lewis, First Washington**

Great Falls, Mont.-based D.A. Davidson & Co. has added five offices in Washington (Bainbridge Island, Burlington and Port Angeles) and Oregon since mid-December. In the case of two of those offices, Davidson picked up brokers who had been with Smith Barney, which decided to close offices in the region. A team of four brokers who had been with Oppenheimer & Co. for 18 years recently left the company to join Seattle-based Freestone Capital Management. "With many large financial institutions forced into 'bear hugs' with former competitors or requiring staggering taxpayer bailouts," says Andrew Erisman, who was part of the Oppenheimer team and is now managing director at Freestone, "clients are asking, 'If you can't handle your own money, why should I trust you with mine?'"

Erisman says boutique wealth management firms also do a better job of working as a team to focus on client needs than Wall Street firms in which each broker tends to compete with other members of the same firm.

"We have been hiring from the so-called wire houses," adds Scott McAdams, president and chief executive of Seattle-based McAdams Wright Ragen Inc. "Most of these folks were exposed to a regional firm at some point in their careers and ended up at a large firm via industry consolidation. While that was problematic enough, it was exacerbated by the large firms muddying up their own reputations and brand names in the last 18 months. That combination has pushed a number of these folks out the door.

"Honestly, it is the best recruiting environment that I have seen in the 10 years that we have been in the business."

Jones of Brighton Jones says he has had conversations with three groups that manage a combined $8 billion in client assets. "These are long shots," he notes, "but it's conceivable that we could go from $1.5 billion to $10 billion pretty quickly."

KEEPING IT SIMPLE

Here's another shift in the market that could play in local money managers' favor: More than one local money manager has noted the difficulty of competing with big firms in offering (supposedly) high-return investments. "We had clients who asked, 'Why aren't you into hedge funds?'" says Carla Wigen, vice president and senior trust officer at Spokane-based Washington Trust Bank's Seattle office.

Local firms can more convincingly make the case that they didn't dabble in the more exotic flavors of investments that caused the most damage, and potential clients may be more willing to listen to lectures about the tradeoffs between risk and reward. "The reality of what that downside could be is much more tangible to them now," Wigen says.

"When markets are doing well, most investors claim they are willing to take risk" to reap higher rewards, WSU's Richard Sias says. "When markets suffer, however, people usually want a more conservative portfolio," such as a mix of stocks, bonds, real assets rather than all in the latest hot stock.

Wall Street firms once lured customers by offering them exclusive access to the hot IPOs and derivatives their firms were underwriting. Now, many investors have been burned by those "hot" instruments and are staying away. "Clients are looking for investments that are transparent and easy to understand," says McClure. "The regional players tend to stay in areas like straight old stocks and bonds that are very easy for clients to understand and easy to explain."

Meanwhile, there is growing recognition that the products sold by Wall Street firms on commission may not always be the best instruments for investors. Many investors are turning to fee-only financial advisers who have no incentive to push one instrument over another.

Symetra, which markets investment and retirement products such as annuities to banks, employers and other distributors, is seeing much greater interest in more straightforward fixed-interest products, Lindsay says. "Banks are coming to us and saying, 'Look, we want to make sure we've got stuff that our advisers understand, that customers understand.'"

"It's kind of a return to the basics," McAdams says. "We'll see how long that lasts."

Among local firms, many observers believe the larger companies—those managing over $1 billion—may be best positioned to grow in the current environment by adding new financial advisers or absorbing smaller firms. The market meltdown will result in a winnowing of weak players, local and national, small and large, and the consolidation of others seeking to cut costs. Hendrix says he expects the 2009 list of Washington money managers will have 20 to 30 fewer firms listed than the 337 on the 2008 list.

"I've gotten calls, 'Do you want to merge?'" McCormick says, from firms dealing with overhead costs that are the same while revenue has been sliced in half. "I think there's going to be a shake out, probably at the smaller end."

"The general state of the industry was that it got too large," says Leonard Brennan, president and chief executive of Rainier Investment Management. "There were too many marginal players. When the day of reckoning comes, a lot of marginal players [will] have a difficult time." He cautions that the survivors will need scale to withstand down cycles and to prove to clients they're sustainable.

While the region doesn't have a lot of big money-management firms, Seattle and the Northwest do have a lot of self-described boutiques, and more may appear as money managers (some of whom find themselves orphaned by national firms closing or in retreat) decide to start their own firms.

While McClure is referring to broker recruitments, he could just as easily be speaking about an investor sentiment that local money managers hope will enable them to reclaim customers and their investment dollars: "When people get uncertain, they start to look at alternatives." SB

First Washington Chairman and CEO, David Lewis

FIRST WASHINGTON CORP.

ACROSS THE GENERATIONS

If it isn't Seattle's oldest money management firm, First Washington Corp.—founded in 1937—has to rank near the top for longevity. First Washington does stake a claim to being the oldest independent securities broker in the state.

That record would suggest the firm has been through a few bruising markets before—unless, of course, the people managing the money are relative newcomers who have only known bull markets.

First Washington has that aspect covered as well. "We have three people who are over 80 years old who work for clients every day," says David Lewis, the company's chairman and chief executive.

That long-term experience brings continuity to First Washington, which has been handling some families' investments for several generations.

But does continuity matter in recruiting the investors of tomorrow, whose families haven't done business with it for so many years?

"That's every firm's challenge, to remain relevant," says Lewis, a former co-chief operating officer at Ragen MacKenzie who formed his own investment company before joining First Washington in 2003.

Not to mention maintaining what works while making changes needed to adapt the company to a new environment. Lewis has been adding brokers—the company now numbers 18 employees—and five years ago, started a money management business to handle larger pools of investment dollars, recruiting veteran Seattle money manager Jack Morbeck, co-founder of Olympic Capital Management, to run it.

"Making the talent evident will be the key to our success" in recruiting not just customers but also brokers, Lewis says, "who find themselves lost in these bigger firms."

But First Washington, he adds, still has "a fairly straightforward business. ... Our mission is to build capital for our clients." The company's relative small size and independence will be prime points of differentiation. "At the end of the day, you need a place you can go where you can get the right advice. You need to establish a place and a culture where people work it the same way."

Just as Lewis and the current owners and employees inherited the business from previous generations, Lewis vows to keep passing the torch to the next generation. "We're going to pass this business on to the people behind us." —*Bill Virgin*
