Defeating Negative Compounding: How Financial Firms Can Help Reduce Wealth Inequality

Opinion Snapshot

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Introduction

"Compound interest," Albert Einstein is supposed to have said, "is the eighth wonder of the world"—a force more impressive, he possibly thought, than that of gravity, black holes, and nuclear energy. Though well-known, this quotation is often left unfinished. The story goes that Einstein ended with a reminder, "He who understands [compound interest], earns it;" and, more important, a warning, "He who doesn't, pays it."[1]

Hidden in these words we find the key to understanding and, we hope, diminishing wealth inequality in the United States. As this Einstein story cautions us, compound interest can be just as catastrophic as it is miraculous. Indeed, it's what makes the rich richer. Yet, its reverse, ***negative compounding***, makes the poor poorer. The purpose of this paper is to identify how investment and wealth managers can help reduce wealth inequality by working to address 'negative compounding.'

'Negative compounding' refers to the fact that those with the least amount of wealth have the most barriers to building it. In order to beat poverty, our poorest Americans must be able to accumulate an investable sum of money, attain the "knowledge and confidence [necessary] to navigate wealth-building decisions," and access products and services which enable their assets to compound over time.[2] Only by helping poor Americans overcome these three barriers can investment and wealth managers help reduce 'negative compounding' and, therefore, reduce wealth inequality.

Investment and wealth management firms run on the mathematics of compound growth, known as the “Rule of 72.” The success of a firm depends on the compounding growth of assets under management (AUM) and, so, the growth of the company’s asset-based management and advisory fees. Money makes money, as the saying goes, and the money that’s made makes more money—a continuous doubling of wealth over time.[3] So, what’s the formula? One part, as we just referenced, is the Rule of 72, which is a way to estimate the number of years required to double one’s money at a specific rate of return.[4] For example, if your investment earns eight percent per year, divide 72 by eight to calculate the number of years it will take for your money to double at that rate. In this case, it would be nine years. The equation (Y = 72 / annual rate) and graph is demonstrated in Exhibit 1.

Exhibit 1: The Rule of 72[5]

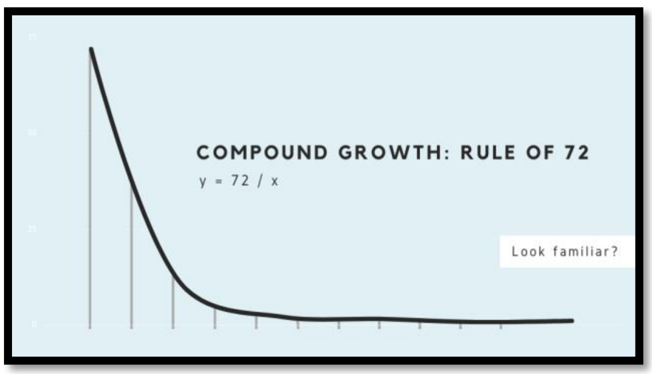


Exhibit 2: Pareto Distribution of Wealth[6]

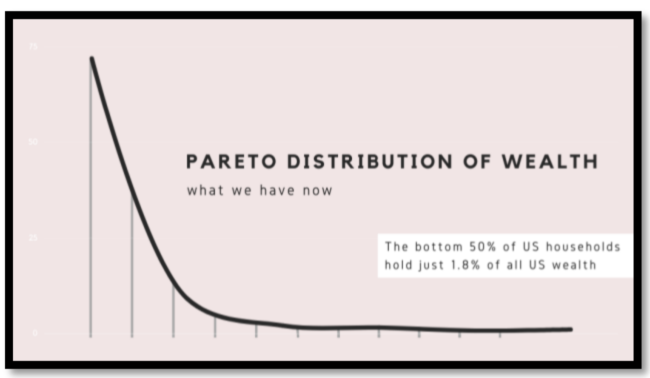
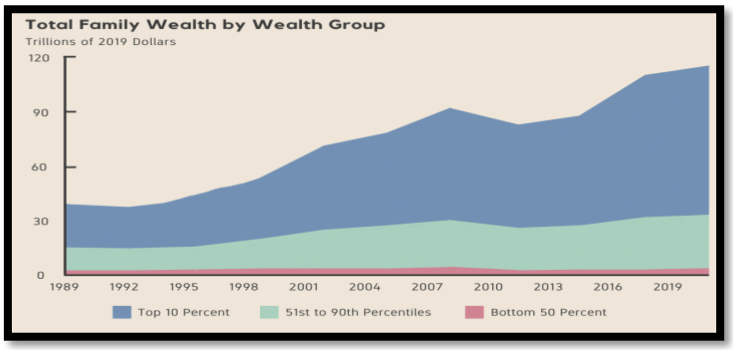


Exhibit 2 is a Pareto distribution of wealth. In it, the X-axis represents the percentage of population, whereas the Y-axis represents the amount of money they hold. Notice how wealth spikes at the 1%, those few citizens on the left-end of the distribution. The vast majority of money sits in the hands of just 1% of the population. Very few have very much, while the majority have relatively little. This Pareto distribution captures the shocking nature of America’s wealth inequality.

American wealth, as shown in Exhibit 2, reflects nearly the exact same curve as the compound interest graph in Exhibit 1. Why is that? We call your attention to Einstein’s warning; the mathematics of compounding and Pareto’s distribution of wealth are intimately tied. The few who understand (and have access to) compound growth amass the majority of money, while those who do not understand (or do not have access to) compound growth are prevented from accumulating very much at all. Again, this is what we call *negative compounding*.

According to the Federal Reserve's 2022 report, the poorest 50% of all American households—that is, nearly 65 million households—hold just 1.8% of all national household wealth.[7] Of that half, the poorest quartile — 32.5 million American households — have negative net worth, meaning they have more debts than assets.[8] The average per-family wealth within that bottom quartile was –$11,000 in 2019.[9] In contrast, the top 10% of families hold nearly 50% of all American wealth.[10] Exhibit 3 illustrates the gravity of these statistics—that small red line represents half of all American families.

Exhibit 3:
Percentiles of Family Wealth[11]



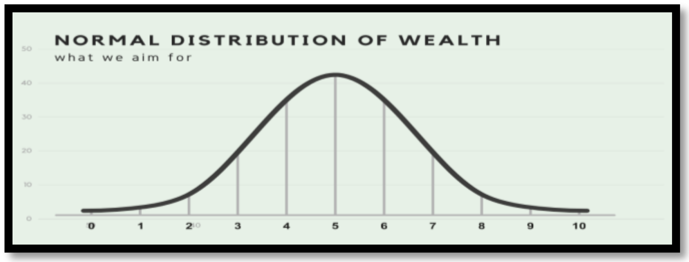
The median American household has a net worth of $121,700, all real estate assets included.[12] **This means that 65 million households, half of all Americans, have less than $121,700, with 32.5 million families with negative wealth.**

So, America's distribution of wealth is Pareto in nature; it follows the Rule of 72. Compounding pulls each end of the distribution tighter and tighter, concentrating wealth in the top 1% while depriving the bottom 99%. For reference, U.S. billionaire wealth climbed 1,130% between 1990 and 2020, while, at the same time, median wealth grew a mere 5%.[13] Thus, we conclude, the gap between our upper and middle classes may be better described as a chasm, and the distance is only widening.

This paper uses a traditional definition of wealth: assets minus liabilities.[14] Here, "wealth" includes a household's savings and the value of its real estate but does not consider the present value of Social Security or pension payouts.[15] Social Security, because of its universal coverage and progressive benefits, does help mitigate this wealth gap. Yet, that gap remains a chasm, especially during a family's working life.[16] In addition, "wealth inequality" should be understood as something distinct from "income inequality," although they are related. This paper will wrestle with the former, because wealth inequality seems a tougher opponent to beat. "Wealth inequality" stems from decisions that have negatively compounded, arguably, over centuries. Therefore, if we want to create long-lasting solutions, we must attack the long-lasting issue—*wealth* inequality.

Such inequality breeds instability, whether it comes in social or political form.[17] A stable economy should look more balanced in its income distribution — a healthy bell curve, consisting of a large middle class, with gradual tapering on the upper and lower ends.[18] As the national gross domestic product (GDP) grows, everyone's wealth should increase, shifting the whole distribution in a more equitable direction.

Exhibit 4: Normal Distribution of Wealth[19]



To understand compound interest, as the Einstein story suggests, is nothing less than a superpower—and investment and wealth managers wield it. They put the Rule of 72 into practice each day. Again, this math serves as the very foundation on which investment and wealth management firms operate. So, they are the perfect professionals to fight the *negative compounding* of wealth inequality. The question is: **Why should investment and wealth managers attempt to reduce wealth inequality?**

The answer is simple: As wealth concentrates, so does the investment and wealth management market. Wealth inequality threatens the long-term stability of their industry. Even now, America's top 1% holds more than half the national wealth invested in stocks and mutual funds.[20] Negative compounding shrinks market potential, making firms compete for fewer and fewer—albeit, wealthier—clients. To broaden wealth is to expand your client base, stabilize the industry, and safeguard your long-term success. Reducing economic inequality is therefore a long-term investment…and a very necessary one, at that.

We, members of Generation Z, are now seeking to enter the investment and wealth management industry. We ask ourselves, "What will investment and wealth managers look like over the next 10, 15, and 20 years?" Generation Z will eventually step into your shoes, into leadership positions. And, if the industry does not now begin to reverse metastatic negative compounding, it will find itself serving a very small slice of America. Not only is this immoral, but it will also leave firms in a much worse economic situation.

Thus, this paper serves as a call to action, addressed to investment and wealth managers. Take up your responsibility; advance your long-term survival and success.

We recognize that not every firm can take the same actions—nor should they, as business models differ. Some firms might offer their *time* to the issue. Others might allocate their *talent*. Still others might devote their *treasure*. However they help, it is in the interest of every wealth and investment management firm to help combat negative compounding. We believe that—intuitively—these actions will increase the number of savers and investors and – therefore – increase the number of their clients.[21]

We call on firms to attack negative compounding, and therefore, wealth inequality on one (or more) of the following four fronts:

1. DOUBLE DOWN ON FINANCIAL EDUCATION

- ***Americans must be informed about the Big Three — interest compounding, diversification, and inflation—financial concepts so important they rise above all others.***
- ***This education will serve as a long-term measure, since new knowledge can only compound over time.***
- ***Financial education is essential to any solution but is insufficient by itself.***

2. **INCREASE ACCESS TO COMPOUNDING PRODUCTS**

- ***Access is needed to combat the fact that investment products have historically been biased toward those with more assets.***
- ***To ease access, fees must be lowered and other barriers must be removed.***

3. **INCREASE ACCESS TO FINANCIAL PLANNING AND ADVICE**

- ***Such access would include delivering personal, human advice to below median income individuals and families.***
- ***Challenges include delivering advice and planning to larger groups of people at scale, while still being commercially viable.***
- ***Solutions include supporting disruptive business models, firms, and technologies.***

4. **ENGAGE IN THE PUBLIC POLICY DEBATE ON WEALTH INEQUALITY**

- ***Accelerating the reduction of wealth inequality requires public policy engagement by investment and wealth managers.***
- ***Progress in public policy could help to combat negative compounding comprehensively.***
- ***Not everyone has to agree on the way forward — but positive engagement is critical.***

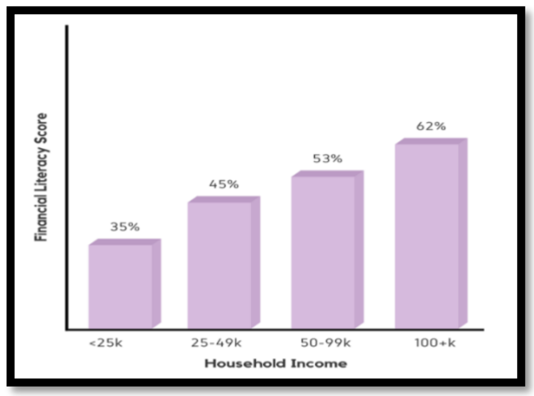
This paper will demonstrate how investment and wealth managers can financially empower those Americans with below-median wealth (less than $121,700) in each of these four areas.

Double Down on Financial Education

As Einstein's "eighth wonder" implies, to avoid negative compounding, one must "understand" positive compounding. In other words, financial education is necessary to reducing wealth inequality.

A 2020 survey, conducted by the Teachers Insurance and Annuity Association, shows that financial literacy across the United States directly correlates with income level.[22] Those earning $25,000 to $49,000 scored, on average, about 28% lower in financial literacy than those who made more than $100,000.[23] As Exhibit 5 illustrates below, income is correlated with higher levels of financial literacy. By understanding the power of compounding, individuals will be able to capitalize on it. And without knowing the danger of negative compounding, Americans are more likely to fall prey to it. To inform someone on financial topics is to invest in their long-term financial success. Education pays back — gradually, over time.

Exhibit 5: Household Income by Literacy Score[24]



A question emerges, "What financial concepts, when taught, merit the highest rate of return?" Three areas of financial knowledge prove most effective in creating wealth: interest compounding, diversification, and inflation.[25] Termed the "Big Three," these concepts provide their possessors with the baseline necessary for growing wealth and mitigating risk.[26] According to the Aspen Institute, "22% of those who are financially fragile demonstrate comprehension of these concepts, compared with 76% among the non-fragile."[27] And, as you will see in our discussion about public policy, states of both political colors—blue and red—are taking action to require financial education in public schools. Insights about the Big Three should be infused into their curriculums.

It is important to note that some economists claim that education, *by itself*, will not reduce wealth inequality – and that's likely correct. William Darity, a Duke University professor of Economics and African American studies, argues, "Yes, financial education can be beneficial, but if it's provided without any significant financial resources, it's the equivalent of a recipe without any ingredients… [Some financial education narratives] say that people aren't making the right decisions. My argument is people don't have adequate resources." [28] He makes an essential and clear point; tools without materials cannot create a building.

For this reason, we state that financial education is a *necessary, but not sufficient* solution to wealth inequality. Education is the "recipe," as Darity called it, but needs further "ingredients." We applaud investment and wealth managers' focus on financial education but also affirm that it will not be a sufficient solution on its own. However, we encourage firms to think more broadly – to "double down" on financial education, yet to take Professor Darity's admonition into account. This paper outlines how investment and wealth firms can not only support financial education but combine it with the "ingredients" necessary to complete a successful solution to wealth inequality.

Examples of Doubling Down on Financial Education

As we discussed in our introduction, not every firm can be expected to tackle the issue in the same way. This applies to "doubling down" on financial education, as firms can focus on the three categories mentioned: *time, talent*, and / or *treasure*.

Fidelity Financial Forward

Fidelity Financial Forward is a volunteer program sponsored by Fidelity Investments, the $4.5 trillion investment and wealth management firm headquartered in Boston.[29] The program encourages Fidelity employees to invest their time and talent in financial education. Employees lead free workshops at the firm's regional investor centers across the country. Fidelity has focused on training teachers so they in turn may impart knowledge to their students. An article in *Barron's* states, "Fidelity volunteers, in concert with nonprofit organizations like the Council for Economic Education, have trained nearly 2,000 educators nationwide."[30] As a result, around 200,000 students, some as young as six, have received lessons in financial literacy. To create good financial habits within below-median youth, it is imperative that firms follow in Fidelity's footsteps, investing time and talent.

Invesco's "How Not to Suck at Money"

Firms can also leverage their knowledge and technology — their *talent* — to deliver financial education. Invesco, the $1.5 trillion investment manager, has taken this approach with its free "How Not to Suck at Money" application, which is linked to their well-known QQQ exchange-traded fund.[31] How Not to Suck at Money was created by a marketing team at Invesco that was dedicated to fostering well-informed financial behavior in college-aged youth.[32] This group is led by Emily Pachuta, chief marketing officer of Invesco US, whom we were fortunate enough to interview.

According to Pachuta, the Invesco marketing team began by asking questions and surveying college students. "What are college students interested in learning?" Invesco asked, as it developed the app. "In what way is that education most effective?" The team incorporated students' answers in its development of the app, an interactive roleplaying game, set in a fictional college town, that simulates the use of the Big Three principles. Invesco wrote the app's copy with jargon-free language, using catchy graphics, within practical and bite-sized modules. Exhibit 6 shows the app-interface.

Exhibit 6: How NOT to Suck at Money – Invesco[33]

"How Not to Suck at Money" reaches students in a way that traditional forms of financial education have not before. Their originality has since caught the eye of the NCAA, where QQQ now serves as the official financial education partner.[34] And Ms. Pachuta outlined exactly why this alliance creates a unique opportunity: College sports reach every team, in every city, through every college, year-round. They help college-aged youth from all backgrounds understand the power of positive compounding. Invesco QQQ's "How Not to Suck at Money" sets an impressive precedent use of *talent* to move the needle on financial education.

Morgan Stanley: Reaching the "Haves"

We noticed a firm taking a different approach to financial education and wanted to highlight it here – even though it doesn't fit the traditional way of thinking. Morgan Stanley's contributed their marketing *talent and treasure* to the cause of reducing wealth inequality by educating the people who have money that they should pay attention.

Morgan Stanley's "Everyone Deserves a Shot at Success" campaign is based on its stated belief that "creating a more equitable and representative society begins with investing in access and educational opportunities for all."[35] The company's recent television campaign, featuring golfers Cheyenne Woods, Leylah Fernandez, and Justin Rose (shown in Exhibit 7), used golf as an analogy for life. The commercial opens with her teeing off, playing golf with a diverse group of young people. It advocates, "In order for the next generation to succeed, we have to pass on what we learned . . . because everyone deserves a shot at success."[36] Morgan Stanley uses their marketing efforts to call attention to inclusive financial education. Viewers of this commercial – golf fans, a generally higher income audience – are asked to reflect on their own role to play in the issue. If they have a wealth of financial knowledge and resources, how are they distributing that to create "a more inclusive tomorrow?" and give all a "shot at success."

And notice how Morgan Stanley's actions do not *directly* provide financial education. They instead use the company's marketing efforts, its *talent* and *treasure*, to call attention to the need to provide greater access and more inclusive financial education. Viewers of this commercial—namely, golf fans, a generally wealthier audience—are asked to reflect on their own role in addressing the issue of financial inclusion. If they possess financial knowledge, how are they distributing it to create, in the ad's words, "a *more inclusive* tomorrow"?[37]

Exhibit 7: "Everyone Deserves a Shot at Success" Campaign[38]

Nonprofits in Financial Education

If, for any reason, time and talent cannot be spared, investment and wealth management firm may choose to allocate their treasure to the cause. Below, we have listed four nonprofit organizations that could use the support of financial firms:

1. **NATIONAL ENDOWMENT FOR FINANCIAL EDUCATION:** https://www.nefe.org/
2. **COUNCIL FOR ECONOMIC EDUCATION:** https://www.councilforeconed.org/
3. **OPERATION HOPE:** https://operationhope.org/
4. **JUMPSTART:** https://www.jumpstart.org/

Why Financial Education?

Financial education is a long-term endeavor, and its effects will be gradual. It is certainly not the singular or immediate solution, but one on which others can grow. We should look at financial education as we do compounding — it improves a small amount each day, and that improvement compounds over time. Every firm can do something on the financial education front. Thus, we wish to encourage wealth and investment management firms to ask themselves:

How can our firm promote financial education for below-median individuals and families — whether that be through our time, talent, or treasure?

Increase Access to Compounding Products

The concept of compounding is critical to identifying how investment and wealth managers can help minimize the wealth gap. Below-median individuals must have access to products which enable positive compounding. Therefore, we call on firms to ask of themselves two questions:

How can we increase access to positive compounding investment products, especially for below-median-income Americans?

How can we increase the rate of return of those products that are already accessible?

The answers will depend on which framework firms operate within: wealth or investment management, retirement, institutional-only, or traditional mutual fund. Some firms serve only institutions, such as pension funds and endowments. Others limit their market to wealthy, high-net-worth individuals. However, many organizations create investment products through advisory, brokerage platforms, or defined contribution plans. And the “wrappers” they offer, from separate accounts to pooled vehicles, matter. Mutual funds and exchange-traded funds (ETFs), for instance, provide a broad audience with access to low-cost, diversified portfolios. In America alone, hundreds of “fund families” offer about 8,000 mutual funds and 3,000 ETFs to the public — available in theory to all investors, including below-median-income families.

Historically, however, the financial services industry has favored the high end of the market for their existing and usually high-net-worth clients. Larger account balances lead to greater profits for firms. So, products that enable compounding are typically designed with our wealthiest Americans in mind.

Because the industry rarely targets new or smaller investors due to their seemingly low profit margins, below-median-income individuals remain underserved.[39] What’s more, products that *do* target poorer Americans tend to be more expensive, thereby reducing their access to compounding over time. This strange point bears repeating: those with *less* wealth pay *more* for the same services. So, in many cases, the people who need compounding the most cannot access it. This is not economically or morally sustainable — such *negative compounding* is precisely what produces our existing unequal distribution of wealth.

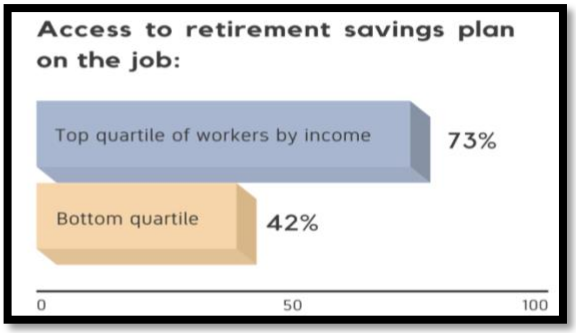
Creating more inclusive investment products must be understood as a long-term investment. Indeed, below-median accounts may offer smaller immediate profits. However, by enabling their balances to compound, their wealth will grow…and so will the firms’ bottom lines. Therefore, we argue that it will benefit wealth and investment management firms to allocate their time, talent and / or treasure to better serve low-wealth investors. This investment may take several forms, four of which will be discussed here: access to employer-based retirement plans; lower-cost, single share class ETFs; model portfolios; and nonprofit organizations that promote such innovations.

Examples of Inclusive Compounding

Access to Employer-Based Retirement Plans

Retirement plans, offered by employers, are the primary vehicle by which below-median-income individuals grow and accumulate wealth.[40] First and foremost, it is important to note that 40% of American employees do not have access to a retirement plan at work.[41] Of that 40%, low-income individuals are disproportionally affected—only 42% of bottom-quartile workers have access to an employer retirement plan, compared to 73% of top-quartile workers.[42] Here, negative compounding reveals itself yet again.

Exhibit 8: Access to a Savings Plan[43]



At both the state and federal level, expanding access to retirement plans proves to be a policy issue, one we directly address in the final section of our paper. However, such a statistic should also concern wealth management firms. Consider that 52% of small businesses fail to provide retirement plans.[44] A SIMPLE IRA is usually the easiest, least expensive, retirement plan a small business employer can offer — and most wealth managers have a SIMPLE IRA product. We challenge these firms to ask themselves a series of questions:

How can we facilitate the use and effectiveness of retirement plans for our small business clients?

Do we have a SIMPLE IRA product?[45]

Are small start-up assets discouraging FA's and planners from encouraging small business clients from setting up a SIMPLE IRA?

Can we create incentives for FA's and planners to encourage small business clients to set up SIMPLE IRA plans?

Diversified Products within Retirement Plans

Nearly 90% of retirement plans begin with a single-step, simple, and diversified investment product.[46] The Department of Labor, which regulates retirement plans, calls these funds "qualified default investment alternatives," or QDIAs, and financially protects employers who choose to automatically enroll their employees into these products.[47]

Most QDIAs take one of three forms. The first are "target-date" mutual funds. These have a set target retirement year for each employee enrolled—from which the manager bases their asset allocation, and the fund automatically rebalances. It becomes more conservative as the employee gets older.[48] Other QDIAs include "managed accounts," which — unlike a mutual fund — are more actively attended to by an investment or wealth manager.[49] Finally, the third form is a traditional, balanced mutual fund, offered by an investment manager. These have a predetermined asset allocation strategy and are continually rebalanced. However, they typically do not become more conservative as the employee ages.[50] Given these three options, investment managers ought to ask themselves:

How can we participate in QDIA investment strategies in retirement plans?

Target date funds, due to their "set it and forget it" nature, are an extremely attractive product—and understandably so. In 2021, target-date funds hit a record $3.27 trillion in assets. The leaders of the target-date industry include Vanguard, Fidelity, BlackRock, American Funds, TIAA, and State Street, many of which also administer retirement plans. The top six firms represent 78.3% of target-date assets, ranging from low-cost index funds (with fees under 0.10%) to higher-cost active strategies (with fees over 1.00%).[51] Overall, the average target-date fee is 0.42%.[52]

Target-date funds are designed to be offered to investors primarily through employer retirement plans, rather than directly to individual investors. Therefore, investment firms tend to offer a lower-minimum share class, with a lower fee, to employers (especially larger employers). But, unfortunately, most below-median-income Americans work at small businesses and, therefore, do not benefit from the same low-fee design.[53] So, again, in the case of target-date funds, we see low-wealth employees pay more for their financial services—their costs compound at a slower rate, detrimental to the individual. If firms do offer a target-date fund, perhaps they should ask:

Why don't we have a single, lower-fee share class for all, or almost all, employers to use in their retirement plans?

Or, can we lower our fees to benefit small businesses and enable below-median-wealth families to better access positive compounding?

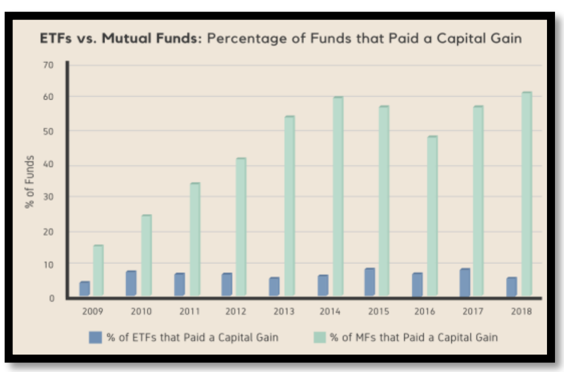
Low-Cost ETFs

Exchange-traded funds (ETFs) serve as an alternative vehicle to or "wrapper" for mutual funds. They provide a more egalitarian, single share class — accessible to all investors, no matter their investable assets. With generally lower fees than active mutual funds, ETFs are an excellent means of providing positive compounding to below median income families. ETFs, with simplicity and accessibility, are a key to democratizing investment.

For instance, with ETFs, the "tax" of negative compounding does not seem to exist—all investors pay the same fees, regardless of their balance. Poorer investors are *not* punished, through fees, for their lack of wealth. Major firms — such as Fidelity, Schwab, Vanguard, E-Trade, and others — offer zero-fee brokerage accounts that allow all individuals to invest in ETFs at the same fees.[54] As another example, Robinhood is a brokerage platform that prides itself on its inclusive and accessible price structure, requiring just $1 to start.[55]

ETFs also possess a unique tax efficiency. Mutual funds incur capital gains throughout the year and are taxed heavily when distributed. In contrast, an ETF minimizes capital gains until shares are sold, thus minimizing the taxes imposed on it. Deferring annual gains allows more of the assets to be invested. The less fees that are deducted, the more wealth there is invested to positively compound over time.[56] See Exhibit 9 for a comparison.

Exhibit 9: ETFs vs. Mutual Funds[57]



The introduction of ETFs in the 1990's disrupted the marketplace. And, through them, four firms rose to the top: BlackRock (iShares), Vanguard, State Street, and Invesco — mainly through indexing. Now, many more firms have jumped on the ETF train, including active managers, such as Franklin, JPMorgan, Capital Group, and American Century.[58] Technology providers have now likewise begun to enable a broader group of investment managers to deliver ETFs.[59] And the question to investment managers, therefore, becomes:

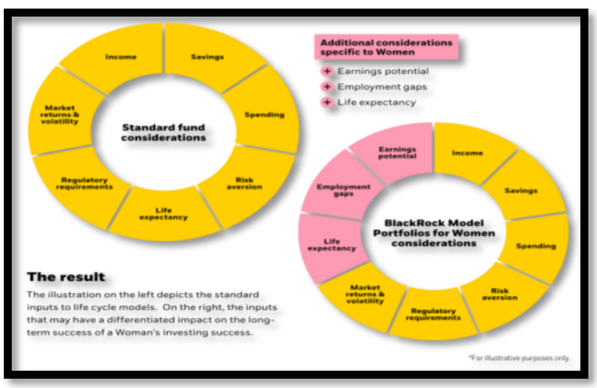
Is it feasible for us to offer our strategies using ETFs as a lower-cost and more inclusive wrapper?

Model Portfolios

The third type of contribution that wealth and investment managers can offer is model portfolios. A model portfolio is "a collection of assets owned by an underlying investor and continually managed by professional investment managers."[60] The asset allocation typically considers an investor's risk preferences, lifestyle decisions, and / or demographics.[61] These models somewhat resemble target-date funds — and are, in fact, used as QDIAs. But, unlike QDIAs and target-date funds, model portfolios are more frequently seen outside of employer retirement plans, yet have smaller minimums. Investors — especially below median income ones — can truly benefit from model portfolios.

First, model portfolios have an advantage over traditional investment vehicles because their assets remain directly owned by the client, rather than being collectivized.[62] The models also, by being thoroughly diversified, reduce risk exposure while still maximizing returns. And a financial advisor or investment manager achieves this diversification through professional expertise, something an individual investor likely lacks. They manage the portfolio according to a client's general objective or demographics. For instance, BlackRock offers a variety of model portfolios — one designed for long-term asset growth, another for generating higher income, and yet another for preserving capital.[63] BlackRock has also leveraged demographic data about women—such as their earning potential, life expectancy, and employment gaps — to create an investment mix specifically for them.[64] Blackrock has redefined what a model portfolio for women would look like by adding considerations that are specific to them. See Exhibit 10 for illustration.

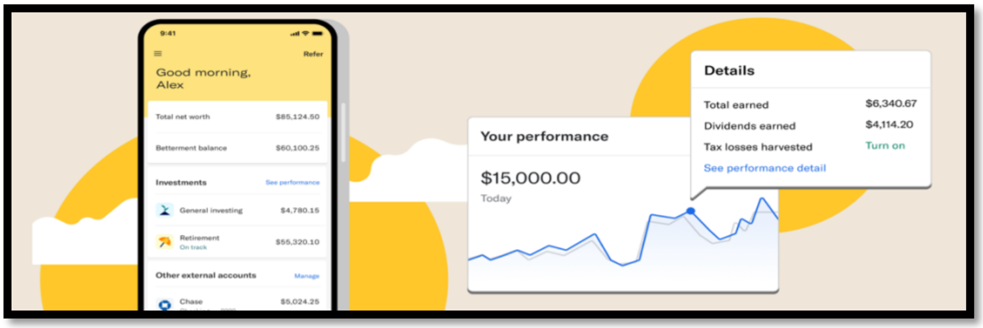
Exhibit 10: BlackRock Model Portfolios for Women[65]



These model portfolios are monitored and rebalanced regularly, while nevertheless minimizing management costs and taxes. This is attained using low-cost ETFs.[66]

These advantages make model portfolios an attractive means of positive compounding, particularly for below-median-income Americans. Better yet, certain "robo-investors" such as Acorn and Betterment go even further to offer lower-cost models. "Acorn investing," for example, does not require high wealth. Every time an Acorn investor purchases something — say, gas, groceries, or clothes — the service rounds that price to the nearest dollar and invests the difference into a model portfolio. Its cost? A mere $3 per month, making it affordable and accessible.[67]

Exhibit 11: Betterment Model Portfolios[68]



And, likewise, Betterment provides clients with a low-cost, automated investment alternative. In Exhibit 11, Betterment's user-friendly and jargon-free design is shown. After each investor fills out a brief questionnaire, Betterment's algorithms build a custom ETF collection for the investor and then automatically monitors and manages the portfolio. Sarah Levy, CEO of Betterment, views the service as a direct means to combat wealth inequality. "There's no question that owning stocks and equities is a privilege of the few," she once said.[69] Betterment aims to change that, to defeat negative compounding, by charging a small 0.25% fee and increasing access to compounding.[70]

Model portfolios—already created, diversified, and automatically rebalanced—allow financial advisors to better serve below-median individuals. Like target-date funds, many model portfolios are "open architecture," meaning the financial advisors that offer them receive a flat fee for their work rather than a commission per amount invested. This protects the investor and ensures that an advisor acts in their best interest. So, the appeal of these products is clear, and firms must ask:

Can we offer (or participate in) model portfolios to help below median wealth Americans beat negative compounding?

Non-Profits That Promote Wealth-Building

Retirement plans, target-date funds, ETFs, model portfolios—these avenues each enable wealth and investment managers to devote their *time* or *talent* to help reduce wealth inequality. However, if these approaches are not practical, a firm can always use its *treasure* to sponsor relevant nonprofits. We highlight three of these nonprofits:

1. Commonwealth

A national nonprofit, committed to building security and opportunity for financially vulnerable individuals.[71] It researches the needs of low-income households and design innovations to serve this cohort.[72] Such solutions are brought to market through partnerships with financial institutions, employers, fintech firms, and funders… perhaps one of which could be you. For reference, BlackRock invests in Commonwealth through Commonwealth's Emergency Savings Initiative.[73] Other supporters include JPMorgan, the MetLife Foundation, and the Rockefeller Foundation.[74] https://buildcommonwealth.org/

2. Center for Retirement Research at Boston College

America's leading center for retirement studies, according to the *New York Times*.[75] It focuses on various retirement areas, such as Social Security, state and local pensions, health care, financing retirement, and protecting older workers. By studying individual economic decisions, the Center crafts solutions that work in practice, not just in theory.[76] And, due to its connection with Boston College, undergraduate and graduate students can get research grants to focus on retirement issues, grants that could be funded by your firm. https://crr.bc.edu/

3. Georgetown Center for Retirement Initiatives

A research institution that seeks "to strengthen retirement security [and promote] the bipartisan adoption of innovative policies, legislation, and administrative models that expand the *availability and effectiveness* of retirement solutions."[77] To do this, Georgetown connects policymakers with scholars and industry experts, analyzes legislative developments, and conducts research. These efforts, however, depend on the funding, the treasure, of generous donors.

Investment and wealth management firms possess a distinct power (and therefore a distinct responsibility) to increase access to positive compounding for below-median investors. To fulfill this obligation, firms may utilize their *time*, *talent*, or *treasure* to promote different products and nonprofits. Regardless of which path firms choose, every firm can combat wealth inequality on some front by making compounding products more accessible. https://cri.georgetown.edu/

Increase Access to Financial Planning and Advice

The less money someone has, the more seemingly impossible it is for them to make more of it. Again, in our third section, we'll describe another instance of negative compounding. It rears its ugly head when below-median-income families seek financial planning and advice; those with the least means pay the highest fees for financial help…if they even qualify for it.

When it comes to receiving monetary advice, access is tightly restricted. Large financial planning and advisory firms typically require individuals to have a minimum of at least six or, more likely, seven figures in income before accepting them as clients.[78] These minimums do little to intimidate their average customers who, for reference, have an existing balance of between $1 million and $3 million.[79] Moreover, even if these minimums are made low enough for below-median-income families to access advice, they will most likely be crushed by the higher fees charged to clients with lower balances.

In 2021, financial advisors charged an average annual fee of 1.2% of a client's total assets under management (AUM).[80] However, as AUM decreases, the advisor's fee (almost always) increases. For below-median-wealth Americans, the cost skyrockets. In fact, it increases by 55%.[81] Exhibit 12 shows typical examples. For example, a client with approximately $5,000,000 in AUM would likely pay 1.2% in yearly fees, whereas a client who has only $250,000 in AUM would pay 1.85% (or $4,625 per year) in fees.

Exhibit 12: Median Fee per Client by AUM[82]

CLIENT'S AUM	MEDIAN FEE
below-median wealth	typical services not accessible
~250,000	1.85%
~500,000	1.75%
~750,000	1.70%
~1,000,000	1.65%
~2,000,000	1.4%
~3,000,000	1.3%
~5,000,000	1.2%

These fees occur annually and, therefore, compound negatively. Any yearly cost, deducted to pay for a financial service, does *not* compound over the following years. For example, imagine you have an AUM of $121,700 (the median American's wealth), and say the account earned a yearly 6% over the next 30 years. If your annual fee was 1.2%

(the industry average), you'd end with approximately $500,000. If, on the other hand, you paid an annual 2.0% (a more realistic fee), you'd have only about $400,000.[83] That's right: a mere 0.8% difference in yearly fees would wipe out 20% of your final account value.[84] Yet again, we see the cost of being a low-wealth individual as it negatively compounds.

The AUM business model has too long been volume-based.[85] Advisors are inherently incentivized to seek fewer and fewer, bigger and bigger accounts. The Pareto distribution tightens. It is for precisely this reason that Morgan Stanley saw its average AUM-per-client increase by 280% over the past nine years.[86] Advisors are motivated to serve the high end of potential clients—to condense wealth, not broaden it.

So, how can finance professionals increase access to financial planning *without* breaking the bank and *without* restructuring the entire wealth management industry? Here are some examples.

Examples of Accessible Financial Planning and Advice Options

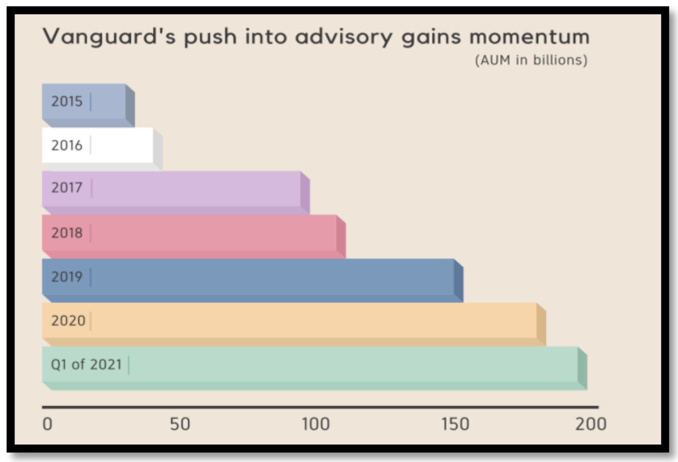
Vanguard PAS, or "Personal Advisor Service"

In 2015, Vanguard set out to serve America's long tail of below-median households.[87] Its "Personal Advisor Service," referred to as PAS, offers a hybrid mix of financial advice and digital investment management. It requires a minimum of $50,000 and charges an "all-in" annual fee of 0.30%.[88] This minimum and the fee are pennies on the dollar in comparison to industry averages. Vanguard, through PAS, enables below-median-income households to access helpful, human-to-human financial advice, all within a cost-efficient model.

How does it work? Clients identify a financial goal most important to them, and the algorithm then recommends appropriate investments, in accordance with a long-term buy-and-hold strategy.[89] Most important, however, PAS customers engage in ongoing, point-in-time advice with a professional advisor, typically over four quarterly phone calls.[90] So, despite its low-cost, PAS depends on human interaction. "Face-to-face relationships will continue to dominate," says Tim Buckley, CEO of Vanguard.[91]

Vanguard took a leap of faith, trusting that our market can sustain (or will even demand) low-cost personal advisory; they now reap the benefits. As of 2021, PAS had a total $186.5 billion in AUM. And Jon Cleborne, head of VPAS, appears only more optimistic. "Growth is accelerating, and this year it is nearly double what we sat at the same time last year [in 2020]," he said. See Exhibit 13 for reference.[92] In an interview with Jason Miehle and Ashley Pontiere, Vanguard professionals, they shared that—regardless of whether the below-median market would prove profitable—the firm was (and is) willing to make the investment. Why? Because "it is the right thing to do," they said, "to live out our [Vanguard's] mission" and "stand for all investors."[93]

Exhibit 13: Vanguard's Advisory Gains[94]



Disruptors of the Advice Marketplace

Now, smaller firms are out to follow in Vanguard's footsteps, to disrupt the industry from the low-end. Clayton Christensen's famous "theory of disruptive innovation" warns incumbent firms that—if they fail to invest in new, disruptive technologies—their services will certainly become obsolete. Out with the old and in with the new, the theory states, or incumbents will lose market-share, slowly, to smaller, more innovative startups. This disruption, according to Christensen, always begins when large firms lose sight of the long-term importance of their "low-end" market, their least profitable consumers.[95] In the financial services industry, the low-end market consists of the median-income and below-median-income individuals so often ignored by major firms. Disruptive firms, armed with innovation technologies (such as PAS or robo-advisors), will steal market share, starting with the low end. The question remains, "What 'low-end disruptors' are on the rise?" We'll feature five companies to look out for, here.

FACET WEALTH

A team of advisors, offering personal guidance through Certified Financial Planners (CFPs) with no minimum asset requirement and one custom, fixed fee. This subscription-based model allows clients to avoid the negative compounding effect of AUM based fees.[96] And, like Vanguard, Facet promises at least four virtual sessions with a professional advisor per year.[97]

XY PLANNING

A advisory firm named for its target market (Generations X and Y). It requires no minimum investment and charges clients a flat monthly fee. Its CFPs do not earn commissions, allowing them to deliver virtual advice while free of bias.[98]

NORTH CAPITAL

A financial planning and portfolio management company, aiding those with a minimum investment of $50,000.[99] Their fees, though asset-based, are 55% below the industry average and provide clients with access to personalized, human-to-human engagement.[100]

IMMIGRANT FINANCE

"A home for immigrant families" to gain curated financial planning and advice at an affordable price.[101] No minimum necessary. The business even offers free masterclasses on immigrant-specific topics, financial advice, and personal consultations.[102]

401 FINANCIAL

A registered investment advisor (RIA) with a special focus in cryptocurrency. This startup aims to advise those with slightly higher investments, starting with $100,000, but will not charge based on AUM.[103] In fact, 401's founder, Tyrone Ross, went so far as to call the AUM cost-structure "a roach."[104] His firm plans to provide *positive* compounding for the "right now investor."[105]

Think about the role of investment and wealth managers in relation to these disruptors. Can they provide equity support? Are their wholesalers calling on them? Before disruptors own this sector of the market, perhaps incumbents should invest in it as well.

Non-Profits in Financial Advice and Planning

Finally, while discussing inclusive financial planning, we cannot forget the importance of nonprofit work. If you cannot allocate your time or your talent to reducing wealth inequality, you can always devote your treasure. Consider supporting this list of pro bono financial advisory firms. Each provides one-on-one confidential and actionable advice to below-median-wealth Americans.

1. **FOUNDATION FOR FINANCIAL PLANNING:** https://ffpprobono.org
2. **PURPOSEFUL FINANCE:** https://www.purposefulfinance.org
3. **ADVISORS GIVE BACK:** https://advisersgiveback.org/launch/
4. **FPA PRO BONO:** https://www.financialplanningassociation.org/advocacy/pro-bono-program
5. **ISC FINANCIAL ADVISORS:** https://www.iscfinancialadvisors.com/pro-bono-financial-planning-services
6. **ABACUS:** https://abacuswealth.com/pro-bono-financial-planning/
7. **BRITEPATHS:** https://britepaths.org/our-services/financial-literacy/
8. **PLANSWELL:** https://planswell.com/financial-planning/
9. **NATIONAL FOUNDATION FOR CREDIT COUNSELING:** https://www.nfcc.org
10. **SAVVY LADIES:** https://www.savvyladies.org

Financial advisors direct their attention, almost exclusively, to the wealthiest members in our Pareto distribution, with little regard for the median or below-median market. This manifests itself in the very fabric of the industry's business models — in high minimum investments and climbing fees. Of course, this pricing is somewhat understandable as it often costs a similar amount to serve someone with less money as it does someone with more, especially for person-to-person support. However, increasing access to financial advice (lowering minimums, lowering fees) should be understood as a *long-term investment*. As Vanguard has demonstrated, the low-end market is viable, so it's only a question of time: Who will win the market? Who will be the disruptors? The median American may only have $121,700 now but, with the right help, their wealth will compound…and so will the revenue of those who invest in the low-end.

Engage in Public Policy

The fourth front to combat negative compounding is engagement in public policy debate on issues which impact wealth inequality. Karen Andres, director of policy and market solutions at the Aspen Financial Security Program said to us in an interview: "In a country where corporations equal people, and money equals free speech, things tend to not happen until big companies start speaking up."[106]

We believe firms have an obligation to speak up, regardless of which specific solutions they may be for or against. This engagement can (and should) take different forms. Some investment and wealth managers might produce research or otherwise raise awareness around wealth inequality. Others can enter direct dialogue with policymakers. Still more may support nonprofits who engage on these issues in a way they can support. These are all ways to dedicate time, talent, or treasure to help mitigate the wealth gap. We present three of many possible policy proposals, worthy of your attention.

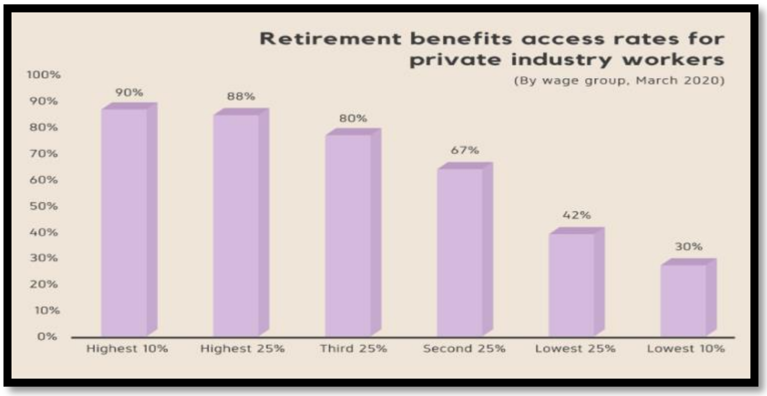
Examples of Policy Engagement

Requirement for Retirement Access

Securing sustainable retirement funds is essential to the financial well-being of every American.

Fidelity estimates that an individual must save 10 times the income they are earning at age 67 to generally maintain their lifestyle in retirement.[107] Yet, according to a Federal Reserve survey, Americans aged 65 to 74 have median savings of merely $164,000, a number far from sufficient.[108] Perhaps this grave discrepancy is a symptom of a widespread lack of access to retirement plans. As Exhibit 14 demonstrates, 90% of our highest-paid workers can access an employer-sponsored retirement plan, while just 30% of the lowest-paid workers can.[109] And, what's worse, 83% of African American senior citizens lack adequate retirement assets to remain solvent in their post-retirement lives.[110]

Exhibit 14: Retirement Benefits by Income[111]



We had the pleasure of speaking with Lisa A. Massena, founder of Massena Associates and former executive director at OregonSaves, who dedicated much of her career to retirement topics. She shared that, in her opinion, "creating access to universal workplace saving is the single most powerful thing we can do to remedy inequality in America today."[112] So, we ask that investment and wealth managers reflect on the question:

How can you promote policies where most (if not all) employers offer some type of retirement plan?

There are two avenues by which this may be achieved: federal and state. We'll discuss each.

FEDERAL (SECURE ACTs):

Over the past three years, bipartisan legislation has helped employers to provide, and employees to access, retirement plans. Most notably, in 2019, Congress passed the SECURE Act. Among its many provisions, SECURE helps small businesses set up cheaper "safe harbor" retirement plans for their staff,[113] and makes it easier to automatically enroll employees in their retirement plan. SECURE was signed by former President Donald Trump and received overwhelming support from both parties in Congress, driven on a bipartisan basis by Congressmen Richard Neal (D–MA) and Kevin Brady (R–TX), chairman and minority leader of the House Ways and Means Committee.[114]

Although SECURE has made it easier for employers to offer retirement plans, it falls short of requiring them to do so. Further federal action, mimicking states like Oregon, could — and, we believe, should — require most employers to offer a retirement plan that automatically enrolls their employees into a diversified investment option like a target date fund. Why? Auto-enrollment proves a maximally effective means of increasing retirement savings, especially for below-median-income Americans. One study, conducted by T. Rowe Price, observed that individuals are nearly twice as likely to save for retirement if automatically enrolled in a plan.[115]

Some financial professionals and political commentators, for this reason, favor the idea of a nationwide auto-enrollment mandate.[116] Among them are Robert Maxim and Mark Muro, researchers at Brookings Metro. Together, they claim this kind of legislation would ensure a financially secure retirement for all. "When a [worker's]…employer does not offer a retirement plan, they [should be] automatically enrolled in a defined-contribution IRA, sponsored by the state and managed by a professional financial services company," the two suggest.[117]

In 2022, the House of Representatives approved the Secure a Strong Retirement Act, commonly referred to as SECURE 2.0. The bill would require that retirement plans automatically enroll employee participants upon their becoming eligible.[118] It also eases the requirements necessary for part-time workers (more likely to be below-median-wealth) to join an employer's retirement plan.[119] So, while SECURE 2.0 does not require employers to provide retirement options, it is at least a step toward standardizing auto-enrollment. Within the House, it enjoyed entirely bipartisan support in this very partisan environment (415–5 vote) and now must pass in the Senate.[120] Neal argues, "A federal program would create a cohesive, national standard, making it easier for employers operating across state lines and improving more Americans' long-term financial security."[121]

The idea of an "Automatic IRA", whereby an employer would be required to at least offer a basic "automatic IRA" was conceived of by retirement leaders Mark Iwry and David John, who now work in retirement security at Brookings.[122] However, although proposed by Chairman Neal on two occasions, such legislation has yet to get real tractio in the House or the Senate.[123] The advocacy of firms would help change that.

STATE AUTO IRAs

Some states have taken up the retirement issue to better serve below-median-wealth citizens by instituting state-mandated automatic IRA programs. This initiative started in Oregon (OregonSaves), then moved to Illinois (Illinois Secure Choice), and finally to California (CalSavers).[124] Now, several states are catching up, including Colorado, Maine, Maryland, New Jersey, New Mexico, New York, and Virginia.[125]

These state programs require nearly all employers to offer an "automatic IRA" to their employees (if they are not offering some other retirement plan). Each state plan provides for the option and ability for employees to "opt out" whenever they wish, and/or transfer their savings to other, private IRAs. However, the "automatic" component of these state programs acts as a force for good, increasing positive compounding for less wealthy Americans. To date, OregonSaves has raised $151 million through 114,000 employers, Illinois Secure Choice has raised $80 million through 105,000 employers, and CalSavers has raised $173 million in 218,000 savings accounts.[126] A success =that the wealth management industry can support. With this in mind, we ask:

How can investment and wealth managers advocate for federal or state legislation that will require employers to offer retirement plans or, at least, an "automatic IRA" to their workers?

Financial Education and Literacy

We've mentioned before the essential nature of financial education. It, like compounding, pays back over time. To systemically invest into our young people, investment and wealth management firms should actively support financial education policy. Such engagement is necessary to expedite and sustain change and to directly combat wealth inequality.

Currently, 27 states, through 69 bills, have directly addressed financial literacy.[127] Of them, seven states already require one semester of financial education before students can graduate high school; these are Alabama, Mississippi, Missouri, North Carolina, Tennessee, Utah, and Virginia.[128] An additional five states are either implementing or are about to implement such a requirement, including Iowa, Florida, Nebraska, Ohio, and Rhode Island.[129] For firms headquartered in one of these areas, this could be an excellent opportunity for engagement.

Carly Urban, economics professor at Montana State University, stated, "Policies that require stand-alone financial literacy courses help students the most, particularly if the states set standards on the subjects that must be included in the curriculum."[130] As discussed previously, financial education demands a well-rounded curriculum, especially emphasizing the "Big Three": interest compounding, diversification, and inflation. To educate below-median-income youth, nonprofits produce teaching materials. One such organization is Next Gen Personal Finance, which offers a free guide to financial literacy.[131] Wealth managers would do well to consider developing similar materials for young people.

Financial education, like retirement mandates, transcends politics. Two states that will soon require financial literacy as a graduation requirement are Florida (a more conservative, "red" state) and Rhode Island (a more liberal, "blue" one).

RED STATE, FLORIDA

On March 22, 2022, Florida Republican Governor Ron DeSantis signed new law. Its goal? To provide students with a stable financial foundation before entering adulthood.[132] Starting in 2023, Florida high school youth will be obliged to take a financial literacy course, prior to graduation. The course includes lessons on opening a bank account, balancing a checkbook, money management, credit scores, personal debt, loan applications, federal income taxes, and investing.[133] This law is an important initiative in closing the wealth gap through financial literacy, which we hope will implicitly create a domino effect causing other states to soon follow their lead.

BLUE STATE, RHODE ISLAND

On the other side of the political spectrum, Rhode Island Democratic Governor Daniel McKee signed a law that created an academic standard for financial literacy in public high schools.[134] The law demands that all students be well-versed in consumer education upon graduating high school.[135] "Many young people just don't understand the complexities of credit and debt," explained State Representative Mia Ackerman, "what it means to have a mortgage that's underwater, or how high interest rates can bury them in debt for their entire lives."[136] She echoes Einstein's warning: just as interest can compound, so too can debt grow. And, only by educating our youth on these matters can we protect them against that debt.

Baby Bonds

The educational policies mentioned above should help below-median-income youth understand positive compounding. However, without some preliminary wealth, that education cannot be put to use. For precisely this reason, *baby bonds* should be considered a potential tool in combatting inequality. Baby bonds, simply put, build wealth through a government-funded investment account created at birth for underserved babies. Such an investment would provide below-median youth with the resources necessary to pursue higher education, job training, or housing.[137] This kind of political policy directly addresses the effects of negative compounding. The babies with qualifying criteria include those who come from a low-income households. And, like financial education, baby bonds can be implemented at both the federal and state levels.

FEDERAL: BOOKER BILL

In 2019, Senator Cory Booker (D-NJ) introduced his "Baby Bond" proposal.[138] The American Opportunity Accounts Act suggests a fixed payment of $1,000 to be paid to every U.S. child, with accumulating deposits that could reach $2,000 annually until they reach the age of 18, subject to household income.[139] So, though all children would receive equal initial deposits, a staggered supplemental payment by income would benefit low-income children at a larger rate. This would, in theory, reduce the effects of negative compounding and so combat our Pareto distribution. Based on estimates of recent return patterns, impoverished children could possess as much as $46,215 by age 18.[140]

Exhibit 15: Annual Income and Supplemental Payment[141]

Income as % of federal poverty line	Income for family of 4	Supplemental payment annual amount	Est. account balance for 18 yr. old
<100% of FPL	<$25,100	$1,000	$46,215
125% of FPL	$31,375	$1,500	$35,081
175% of FPL	$43,925	$1,000	$23,948
225% of FPL	$43,925	$500	$12,815
325% of FPL	$81,575	$250	$7,248
500% of FPL	$125,715	$0	$1,681

According to Senator Booker, this plan would cost about $60 billion per year, and the bill originally included a tax increase which, according to the Committee for a Responsible Federal Budget, would have generated enough revenue to pay for the increased expenses.[142]

STATE PILOT PROGRAMS

Connecticut saw Senator Booker's vision and took the leap of faith. In 2021, the CT Baby Bonds Program was born.[143] Through it, children enrolled in Connecticut's Medicaid program, "HUSKY," receive the tools — the positive compounding — needed to build a financial foundation. Each child is allocated $3,200, invested into a trust, which could then accumulate up to $11,000 from birth to when the child turns 18.[144] When the individual reaches the age of 18, they will gain access this wealth and so gain access to otherwise impossible opportunities. State Treasurer Shawn T. Wooden, who oversaw the project, commented, "Thousands of children in Connecticut who are born into poverty will now grow up knowing that they have access to Connecticut baby bonds, which can change the trajectory of their lives."[145] Children born during or after July 2023 will be eligible for the program, and we hope to see its benefits come to fruition. In addition to Connecticut, Pennsylvania created a program entitled "Keystone Scholars," where their 529 program opens an account for each baby born in the Commonwealth and makes a $100 opening deposit.[146] And, in Wisconsin, a bipartisan group of legislators worked with the Treasurer's office to propose 401KIDS, in which every child born or adopted in Wisconsin would be enrolled in an IRA-like "target date" account, seeded with $25. Parents and grandparents could then make additional deposits from there.[147]

The Urban Institute wrote a paper in 2021 entitled "Baby Bonds Provide an Opportunity to Close the Large Racial Wealth Gap,"[148] and the Business Roundtable, an organization made up of the CEOs of America's largest companies, suggested that Congress create a pilot program to test the effectiveness of baby bonds.[149] However, for many reasons, baby bonds have not attracted as much bipartisan support as automatic enrollment, financial education, or even an "Auto IRA". However, it is nonetheless a creative solution to wealth inequality—using positive compounding in our favor—and worthy of analysis and, perhaps, the engagement of wealth managers

Nonprofits Engaging on Public Policy Issues

Whether *time*, *talent*, or *treasure* is devoted, or whether firms lean red or blue, all investment and wealth managers have a role (and, more important, a responsibility) to engage in the policy debate on wealth inequality. Not every firm can do everything, but every firm can and should do something on the policy front. This discussion must be had in every area, with every policymaker, and at every level:

local, state, and federal. Advocacy is a privilege each citizen has, and firms who benefits from compounding should use this privilege to mitigate wealth inequality. So, we call on investment and wealth management firms to consider their role, take responsibility, and engage in this morally and economically critical issue.

1. **ASPEN INSTITUTE FINANCIAL SECURITY PROGRAM:** https://www.aspeninstitute.org
2. **BROOKINGS INSTITUTION RETIREMENT SECURITY PROJECT:** https://www.brookings.edu
3. **BIPARTISAN POLICY CENTER / FUNDING OUR FUTURE:** https://bipartisanpolicy.org/policy-area/economy/
4. **AARP POLICY INSTITUTE:** https://www.aarp.org/ppi/
5. **URBAN INSTITUTE, RETIREMENT POLICY:** https://www.urban.org/tags/retirement-policy
6. **AMERICAN ENTERPRISE INSTITUTE, RETIREMENT POLICY:** https://www.aei.org

Conclusion

What is one of the biggest threats to the survival of incumbent investment and wealth management firms? Clayton Christensen, who formulated the idea of "disruptive innovation," spent his life answering this question across all industries. He coined the term 'disruption.' It is the process by which, despite all odds, an established, successful company loses significant market share and finally fails at the hand of a smaller, less-established one. Christensen concluded that seemingly well-managed incumbent firms fall from success when they forget the long-term importance of serving low-end customers.[150] These businesses pursue higher margins and wealthier high-end clients at all costs, blinded by short-term gains and impressive quarterly reports. It's a slow and silent death, disruptive innovation.

Who, in the investment and wealth management market, are the high-end and low-end consumers? American wealth follows a Pareto distribution; very few have very much. These high-wealth individuals constitute the high-end market. Their large assets-under-management result in large asset-based management and advisory fee revenue. Thus, these accounts are highly profitable for investment and wealth managers and easily attract their attention. As Christensen's theory of disruptive innovation predicts, incumbent firms chase the high-end market, almost exclusively.

The median American household has $121,700 in wealth, all real estate included.[151] So, the low-end consumer may be defined as those 61 million American households with less than $121,700. This includes the 13 million American households with negative wealth. Such individuals are often underserved and overlooked by investment and wealth management firms; their low asset levels yield low fees for the managers of their assets and their financial advisors, if they have any such managers. This fact, on its surface, appears economically reasonable and explains why investment and wealth managers pursue the most profitable high-end clients. However, as Christensen warns, serving the low-end market is essential to long-term survival. "Disruption" occurs from the bottom up.[152]

Why should investment and wealth management firms attempt to better serve low-end consumers and, consequently, reduce wealth inequality? As time goes on, wealth compounds. At the high end, it compounds positively. In the low end, negatively. The rich will continue to build wealth with relatively little struggle, while the poor will struggle more.

As wealth concentrates among fewer and fewer people, so will firms' potential clients. Negative compounding causes firms to compete for fewer and fewer wealthy clients. Even now, most investment and wealth management firms serve a very small slice of America. Imagine how much smaller that slice will be in just eight years—when the top 1% is predicted to hold 64% of the world's wealth.[153] Less potential clients will make for a less stable and more competitive overall industry.

So, broadening wealth is a necessary investment. The median American may only have $121,700 now, but with the right help their wealth will compound…and so will your revenue. To reduce wealth inequality means to expand your client base, stabilize the industry, and safeguard your long-term success. It's the way to diversify your risk, targeting the majority market rather than just the most profitable one. Christensen urged firms to embrace "low-end" consumers as the key to avoiding disruption.

How can investment and wealth management firms invest in the "low-end" consumer, fight wealth inequality, and so promote their long-term survival? No firm can do everything, but every firm can do something to fight negative compounding. Different firms can—and should—invest in different solutions, according to what their business models allow. Some may allocate their **time**. Others, their **talent**. More, their **treasure**.

We, like Einstein, leave you with a warning: The responsibility to serve our nation's below-median households is not merely ethical; it's essential to our industries' economic survival.

Author Note

In this paper, we emphasize the importance of how wealth and debt compound over time. The younger the person, the more time they have to benefit from positive compounding – or be buried by negative compounding. We approached this topic from the perspective of time, in part, due to our own ages. Each author here is a member of Generation Z. That being said, we recognize that the financial services industry, American economy, and political landscape will be subject to much change over the coming 10, 15, or 20 years. Through our Opinion Snapshot, we merely hope to present educated predictions about how wealth inequality will intensify over time and suggest ways that investment and wealth managers might combat it. These opinions, informed by our research, belong to the members of our group. We would offer our gratitude to the Sapere Aude Consortium – especially, Joe Craven and Chris Bendel – for supporting us in this endeavor. And, finally, we would like to thank Karen Andres, Lisa Massena, Ashley Pontiere, Jason Miehle, Emily Pachuta, Julianna Samper, and Anahit Fitzpatrick for sharing some of their "time" and "talent" to help further our work.

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