Morgan Stanley Keeps Up Recruiting Pace

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Morgan Stanley has been keeping pace with its aggressive recruiting of financial advisors so far in 2008 despite the financial sector's troubles. But some industry observers say that the market uncertainty that has paralyzed other companies this year could hamper Morgan's efforts to continue growing.

When Morgan reported third-quarter results for the period ending Aug. 31 this week, its global wealth management group was a bright spot on the balance sheet, despite a 4% decline in client assets and a $34 million pre-tax loss for the division. That's because the loss was largely due to a $277 million charge for settling auction rate securities claims and the slip to $707 billion in client assets from $739 billion in the second quarter was attributable to declining market values. And the asset drop was offset by the quarter's $13.7 billion in net new assets – the 10th straight quarter of inflows and second-highest inflow total ever for the wealth management group.

One analyst report states that the inflows are no surprise given recruiting efforts that have helped to bring Morgan's advisor count to 8,500 from less than 8,000 a year ago. "Net new asset growth is likely fueled in part by new hires as [financial advisor] headcount increased by 150 during the quarter," write William Tanona, Betsy Miller, and Neil Sanyal of Goldman Sachs.

Morgan began the push last year and according to industry competitors was outbidding the market, especially this year, to bring in experienced advisors. In the first five months of the year, Morgan hired more than 100 advisor teams that topped $1 million in revenue at their prior shops, including several teams that managed billions of dollars in client assets.

The recruiting push for financial advisors, or FAs, is not waning, said Colm Kelleher, executive v.p., CFO, and co-head of strategic planning for Morgan, in a conference call about the earnings late Tuesday. "We continue to successfully recruit high-producing FAs and year-to-date we are seeing record recruiting volume and record-low FA turnover," he said.

Kelleher also said Morgan has not changed the compensation part of its recruiting packages, and that it is hiring "aggressively."

"We're getting a lot of incoming calls – top quality people – and we feel very positive about that business," he added.

Similar themes were evident last week when Rick Capozzi, managing director and national sales manager for Morgan's wealth management group, spoke last week in Boston at the Wealth Management Congress 2008 conference. He said Morgan is "leading the way" this year and recruiting from its main competitors at Merrill Lynch, Smith Barney, UBS, and Wachovia.

"It's a significant part of our growth," Capozzi said. "It is not easy trying to move or persuade someone that's been with Merrill Lynch for 25 [to] 30 years and trying to move a book that may have $700-800 [million or] $1 billion in assets, so we're very focused on that part."

Just this week, Morgan announced a new team joining it from Smith Barney as it adds Brian Katz and Craig Bloom to the Beverly Hills, Calif., office.

In responding to a question about how Morgan could afford to pay a large number of big recruiting bonuses, Capozzi said that the industry trend toward signing advisors to nine-year deals justifies the long-term cost of the packages because there will be "a better probability" to make money from that advisor's business in the long run.

"[T]he race is how do you capture market share?" he said. "The truth of the matter is you don't always make money on every financial advisor. You do make money if you hire successful financial advisors that transition well."

Market observers say it appears Morgan indeed has remained active. Darin Manis, CEO of RJ & Makay, a recruiting firm based in Colorado Springs, Colo., conducts advisor searches for other top brokerage firms and says he continues to come up against recruiters working on behalf of Morgan.

"There's no stop on [Morgan's] side at all," Manis says. "They did pull back a bit on their deals, but to be frank, whenever they have someone they want or they're competing with you, they go back to the maximum deal they are authorized to do in that office or region. They are flexible for anyone they want and are competing to recruit."

One recruiter who requested anonymity says Morgan may find it harder to recruit in the wake of Sunday's rapid-fire deal that would sell Merrill Lynch to Bank of America, because Morgan and Merrill had similar "independent" investment bank identities. The source says that financial-market pressure on Morgan to pair up with a large commercial bank is inevitable, and until it could derail recruiting efforts until it subsides or results in a deal.

"It won't slow them looking, because you always look for the best advisors, but people are anticipating they will team up with someone," the source says.

Even last night, rumors spread on Wall Street that Morgan was in talks to merge with Wachovia. Some analysts don't think the markets are certain to force Morgan's hand. An analyst report by Guy Moszkowski and M. Patrick Davitt of Merrill issued yesterday states that the "independent, leveraged investment bank model…is not really in question if risk is managed well." Others, such as Glenn Schorr, Mike Carrier, and Keith Murray of UBS, see the pressure mounting on Morgan. "[W]e think funding costs will become a significant issue in the coming months given the very elevated credit spreads, which could squeeze profitability," they wrote in a report issued yesterday.

Still other analysts say despite market conditions – and partly because of them – Morgan is likely to be in a strong position to recruit. Goldman's trio of analysts wrote, "We expect the number of advisors and assets to continue to grow over the next few quarters as Morgan Stanley is in a unique position to make attractive new hires." A Morgan spokeswoman did not respond to a request for comment on the market reaction.

The flip side of the uncertainty is the possible impact on Morgan advisors themselves, says Manis, the recruiter.

"Are Morgan Stanley brokers concerned? Of course," he says. "Brokers have a lot of their retirement tied up in deferred stock in their company...We are barely keeping up with the incoming calls we are getting this week from Merrill and Morgan Stanley brokers who are wanting to at least evaluate their options."