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Recently, I found myself daydreaming about the future of the wealth management industry and soon thereafter had an opportunity to discuss that dream with a few industry participants. Interestingly, we all agreed that there were a few unmistakable trends that seemed to make a great deal of sense, and the point of this letter is to share them with our readers. We will thus review both three alternative models for success and a couple of potential changes in the way traditional activities are carried out.

Three totally different kinds of service providers seem likely to prevail over time.

Operations-based wealth managers: starting from well-established custody and transaction processing platforms, these firms would provide a service that is geared to the last two phases of the wealth management process (implementation and monitoring). They will focus on custody, trusteeship, performance reporting, and manager assessment, and will integrate upstream into the "low-tech" end of the asset management process, with activities such as cash management, core municipal bond management, and even active tax management of equity portfolios.

Boutiques: these providers focus on one or two critical services and aim to be the absolute best there. They are comfortable not being at the center of the relationship with the client, and rather therefore base their success on sheer excellence. Note that these firms are not limited to the narrowly defined asset management world, as they would certainly encompass first-class estate planners, tax accountants, family governance experts, philanthropic advisers, and a variety of other individuals, whose main goal is to serve the high-net-worth investor.

Multi-family family offices: based totally on the concept of open architecture, these firms align their interests and those of their clients in the most careful manner possible. They aim to serve as the quarterback of the relationship, facilitating the hiring and firing, by their clients, of the best of the best in all the fields of endeavor, and providing integrating and concierge services. A critical element of these providers is that they bend over backwards not to offer individual products, limiting any "packaging activity" carried out within their firms to those actions necessary to simplify

THE JOURNAL OF
WEALTH
MANAGEMENT

the life of their clients or to provide them access to strategies that would otherwise be inaccessible. A logical part of the life cycle for many of these firms will likely involve being acquired by large institutions, who would use them, and their brands, to provide wealth management services to these institutions' in-house clients (many of whom would in time be tempted to move toward the more attractive open architecture model).

Note that the fact that one can see these three models as most likely to succeed does not mean, as many of us learned in high school, that other models would not. Indeed, just as the "most likely to succeed" high school graduate does not always succeed, a few other models may well prove quite successful if executed flawlessly. Thus, large institutional fund managers or firms combining sell- and buy-side activities can still strive, particularly if they have something special to offer, such as unique networking capabilities or particularly brilliant employees who are sought by clients attracted by their capacity to come up with new ideas.

These models do not necessarily find themselves limited to the ultra-affluent. Indeed, a recent industry trend provides hope that integrated wealth management, and its cousin, tax-efficient investment management, can eventually be offered to the "mere affluent," defined here as individuals with a few million dollars in assets. David Stein and Greg McIntire introduced the concept of overlay portfolio management in the Spring 2003 issue of the journal and it is easy to dream of its future application on a broader scale, with two interesting implications:

Overlay managers: one can take the concept to be the model for tax-efficient investment management. Indeed, this would simply require a service provider, here an overlay manager, to invite the managers chosen by each client to provide model portfolios. These portfolios would then be aggregated into a client-specific target portfolio, with the possibility of there being one such target portfolio for each client (as each has their own list of managers, comprising from one to as many managers as desired). Optimization software is then used to match that target portfolio to the client-specific current holdings, and thus to decide which transaction is reasonable and which is not. The reasonableness of any transaction would be driven by client-driven parameters such as the level of unrealized capital gain in each security, the sensitivity to net realized capital gains (preference for dynamic or static tax efficiency), the need to avoid all wash sales, and others. Note that this activity lends itself more to equity management, where the list of available securities is smaller and where typical portfolio management processes start with stock-specific investment ideas, than to fixed income markets. In the latter, indeed, portfolio management processes typically focus on broader issues, taking advantage of what security is on offer or in demand by traders at given points in time.

Note that this provides an interesting avenue for "boutique" investment managers to serve individual investors without a substantial change in their structure. Though they may have a large number of these individual clients, they would not typically need to be involved in the day-to-day interactions with each client, which require substantial increases in the number of portfolio managers. Rather, they would simply need to manage a limited number of model portfolios, and make broad presentations to large groups of clients on a periodical basis. The day-to-day client interaction falls to the overlay manager, who is really tailoring this "wholesale alpha" to the needs of each client!

A new meaning for master custody: one can imagine a redefinition of the term "transaction processing," expanding it to include the origination of the transaction. Currently, a typical master custodian processes a transaction by matching confirmation slips provided by the investment manager on the one hand and the broker on the other. The investment manager indeed completes a trade with a broker and then informs the master custodian of the specifics of that trade. The master custodian then settles the transaction when he or she receives a matching confirmation from the broker. One could imagine redefining transaction process-

THE JOURNAL OF
WEALTH
MANAGEMENT

ing to incorporate the role of the overlay manager as a part of that process. In that design, a master custodian would receive "model portfolios" from specialized portfolio managers, would thus create the target portfolio appropriate to each client, based on client instructions and proceed through the portfolio optimization to generate appropriate transaction lists. This would naturally dovetail with the fundamental skill set required of a master custodian, as it calls upon such skills as operational excellence, superior electronic execution and control activities, first-class client management skills and the like.

In short, the need to help wealthy, or simply affluent individuals with the management of their assets is just as likely to change the face of the wealth management industry, as the shift we saw in the tax-exempt institutional world in the late '70s and early '80s in response to ERISA, the "big bang" in the brokerage world, and the move from a single—i.e., return-oriented—to a two-dimensional world, where the risk/return trade-off became the focus. The need to move to a world that incorporates multiple new dimensions, such as tax efficiency (both in terms of investment income and transfer taxes), behavioral finance, and other individual characteristics will force the industry to redefine itself. The thoughts proposed here may (or may not) be part of that new framework.

This Fall 2003 issue of *The Journal of Wealth Management* has three principal axes: asset allocation, alternative assets, and tax-efficient management. The first two articles are dedicated to various aspects of the asset allocation process. Jean Brunel starts with a new perspective on strategic asset allocation, building on original work by Meir Statman and incorporating a behavioral finance dimension into the process. Claus Huber and Helmut Kaiser focus on the risk/return characteristics of the asset allocation recommendations for five asset classes (equities, bonds, real estate, hedge funds, cash) and compare them with risk-optimized portfolios.

The second section of the journal is dedicated to a single article by Jeffrey Horvitz and Jarrod Wilcox, which, though much longer than our norm, is very interesting, as it aims to revisit the issue of the nature of tax losses. They show that tax deferral is not an interest-free loan from the government, but rather that the tax code operates more like a partnership carried interest and that the mechanism of tax deferral is a nonlinear function of different compounding rates.

Finally, the last three articles are dedicated to non-traditional investments. Bahram Adrangi, Arjun Chatrath, and Kambiz Raffiee look into the puzzling negative relationship between stock returns and inflation rates in most economies, and investigate this relationship for gold and silver in the context of the Fisherian hypothesis and the proxy hypothesis of Fama. Bruce Paulson focuses on the hedge fund world from an asset location perspective, looking for the attributes that make hedge fund strategies more or less suitable to selected fiduciary holding structures. Last, but not least, Robert Dubil and Maretno Harjoto investigate the common prejudice that states that hedge or venture capital funds are risky; in fact, they use a behavioral finance framework to suggest that they may be less risky than mutual funds.

Jean L.P. Brunel
Editor