THE JOURNAL OF
WEALTH MANAGEMENT

VOLUME 9, NUMBER 3 WINTER 2006

Over the course of the summer, I found myself confronted with an issue that illustrates one of the issues that can confront a number of wealthy families and which the private asset management industry may not have been anticipating. I am referring to the issue of manager evaluation, both in terms of initial due diligence and ongoing monitoring. With different triggers in different instances, it is not unusual for families or individuals to have to reconsider the way in which they conduct their manager selection and monitoring activity. This might involve the loss of a member of the investment team, a distressing experience with a particular manager, a loss of confidence in their traditional investment consultant or adviser or even a philosophical change in the direction of the family office, for instance.

Thinking of the industry as a whole, it is fair to observe that an important stratification is occurring in the industry, with the asset size of the investor an important decision variable. Traditional trust and commercial banks have a very important role in the area of the affluent and near-affluent segment, which, for basic economic reasons, have needs that are efficiently met by the somewhat standardized process, which relies on assigning to each portfolio manager a large number of individual accounts. Though there certainly is a large measure of overlap here, the next level up on the wealth scale has been the area of focus for integrated brokerage houses, whose financial advisors offer both managed solutions and individual investments or deals, and have tended to take the lead in the way towards open-architecture. Multi-family family offices would typically focus on wealthier individuals, who have both the need and the ability to pay for a wider array of services, extending beyond the pure asset management sphere. Traditional investment consultants can then be found to serve families with substantially larger wealth, many of whom actually have structured their own single-family family offices.

As one rises up that wealth ladder, a number of things happen, such as a greater degree of customization, a truer and broader measure of integration of the multiplicity of disciplines that the wealthy need to address and consider, and, within the asset management dimension of the solution, a greater reliance on open architecture structures, which effectively mean that the relationship between the

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family and its advisor involves a higher use of investment managers that are not related to the advisor.

Though each of these categories of service providers has indeed designed individual niches for themselves, it is however noticeable that they have retained some degree of traditionalism in the way in which they approach manager selection. An important element of that typical design is that there are significant limits to the ability of the "client" to direct the due diligence resources of the advisor toward managers that they have themselves identified. This is understandable to the extent that a critical element of the business model of most of these service providers must be that a fixed budget dedicated to manager research needs to be efficiently utilized and spread over the whole clientele.

While that model does indeed make sense, many families or wealthy individuals can find it frustrating. Indeed, one of the aspects of the wealthy community, particularly in the higher reaches of wealth, is that families have unusual access, both to managers and "friends" who themselves use different managers than they do. That simply reflects the fact that the wealthy are on every manager's radar screen and that the ultra high net worth community is somewhat closely knit, and with members quite prepared to discuss one another's experiences. Thus, new ideas circulate rather quickly both because of community dynamics and because new managers want to have these often quite stable investors as a part of their limited partners or clients. Contrast this with the need for the traditional advisors to be able to spread their energy and resources onto a large clientele and it will soon become clear why so few of them have a natural ability to access or an understandable disinterest in focusing on as board a list of managers and on new ideas as much as their clients might wish.

This describes a potentially interesting business niche for a new entrant or differentiating factor for someone already servicing the ultra affluent. The opportunity involves making manager due diligence a distinct service, defined to include both some substantial standard coverage and a specific ability to conduct "directed" due diligence. In many ways, this is the evolutionary analog of the trend we saw since the late 1980's when the industry recognized the need to offer both managed portfolios and the ability to execute self-directed transactions. Prior to that time indeed, many high net worth individuals needed to hire both a traditional investment manager—whose only service related to managed portfolios—and traditional brokerage houses—whose sole focus was on executing individual transactions. Clients then started to ask why they had to conduct their business in such a fragmented manner and smart service providers noted in that trend an opportunity to increase their "share of wallet," by finding a way to combine discretionary portfolio management and self-directed brokerage services. The question before the house today is how to find a way to offer manager due diligence services that combine the analog of the managed portfolio—maintaining a list of managers that the service provider selects—and of self-directed brokerage services—offering due diligence services—both initial reviews and on-going coverage—on managers identified by the client.

To be successful, such a conceptual business model may require a change in the model used by many—though by no means all providers of manager research. In many ways, this is, again, a replay of a movie we have already seen: the way in which investment managers used to allocate research and portfolio management duties. Indeed, in the "old days," the traditional business model for an investment management activity was that portfolio managers were at the top of the food chain, while analysts were at the bottom, their job often considered a training ground for portfolio managers. With the advent of greater competition in the investment management world—up to and including the increased role of so-called hedge funds—that order was at times substantially challenged: the most important component of the investment team might be the analyst, with many concentrated portfolio or hedge fund managers effectively merging the two functions. Similarly, the current practice for manager due diligence to be conducted by relatively junior members of the team will need to be re-thought. Indeed, the ability to perform "directed" manager evaluation, a crucial element of which has to be responsiveness and speed, will

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require the use of individuals with substantial experience and seniority, as they are the ones who can, initially at least, form a reliable opinion with a limited amount of effort. Follow-up, more detailed work, when appropriate, would still likely require the presence of a diversified team of analysts, with varying levels of seniority and experience so that the effort can be made profitable from a business standpoint.

Whether this niche will or will not be captured is obviously somewhat unclear at this time. Whether it will be captured by existing "players" adapting to the different market need or by completely new entries is also unclear. Yet, the fact that quite a few very affluent families are in need of advanced due diligence, the need for that due diligence to be truly forward looking are both absolutely critical in that segment of the market. This is particularly true in a framework where investors focus more sharply on non-traditional strategies—or strategies where manager risk is much more significant than market risk. One can only encourage industry leaders to consider the needs of this market and design appropriate responses to them.

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This Winter 2006 issue of *The Journal of Wealth Management* starts with two articles focused on one of the most esoteric—and yet crucial—dimensions of integrated wealth management: risk, defined as extending substantially beyond the volatility of investment returns. Eric Pruss looks into the many such categories of risk that families must consider and argues that individuals ought to develop a holistic personal risk management program, which would compliment and enhance any of their financial plans. Nicholas Nierengarten focuses on a more specific issue, considering cyber-threats facing individuals arguing that effective wealth management now requires a critical analysis of a financial advisor's ability to anticipate and respond to cyber threats, to how cyber-related risks are contractually allocated between the client and financial advisor, and to the financial advisor's ability to compensate the client (both balance sheet strength and through appropriate insurance).

Our next article still involves the crucial, initial investment policy stage as Matthew Brady discusses the fundamental question of what entrepreneurs ought to do and how they should plan before the company they created goes public through an Initial Public Offering.

Our next two articles relate to the question of portfolio optimization. William Jennings and Steve Fraser propose an application of behavioral finance principles to the strategic asset allocation decision faced by foundations and endowments. Then, Gary Smith, Joseph Steinberg and Robert Wertheimer turn to the question of how one might best address the formulation of return expectations in a mean-variance optimization framework, arguing that historical data may be inferior to informed estimates that reflect one's beliefs about the current financial environment.

Our final two articles fall under the header of the implementation of investment strategy. Michael Dubes looks into the complex area of avoiding the traps in 1031 tenants-in-common exchanges, proposing a series of steps that might be used to maximize the probability of a successful outcome. Finally, Olfa Hamza, Maher Kooli and Mathieu Robergé investigate the predictability of hedge fund returns, concluding that there is some measure of predictability and thus potential profit to be made from a systematic re-allocation or rebalancing among them.

Finally, last, but not least, I would like to welcome two new members to our Board of advisors. Greg Gregoriou is Assistant Professor of Finance Associate Professor of Finance at the State University of New York (Plattsburgh) and has been a prolific writer, both for *The Journal of Wealth Management* and for numerous other publications, with a strong emphasis on non-traditional strategies. Meir Statman is Glenn Klimek Professor of Finance at Santa Clara University and one of the very pioneers in the field of behavioral finance. We thank them both for agreeing to serve and are looking forward to their great insights.

Jean L.P. Brunel
Editor