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ON THE COVER

Twice

Gesso, Iridescent Silver Pigment, Acrylic and Vinyl Polymers, Epoxy, Palladium Leaf on Canvas, 2008
25 inch Diameter Quatrefoil

***Max Gimblett** (New Zealand, born 1935) is a New Zealand based artist known for his contemporary non-objective style of painting such as the work featured. Having a career spanning over 40 years, his work has an established presence within the U.S. and International art markets with holding both solo and group exhibits at major galleries from California, New York and New Zealand. This piece and other works by this artist are available at Haines Gallery located in San Francisco, California. Visit www.hainesgallery.com to view more works by this artist.*

About a decade ago, at one of our Integrated Wealth Forums, a panel discussion brought together three individuals, all from wealthy families. One offered a case study of how things can go badly wrong when children and heirs are not formally educated in what it means to be wealthy. Another offered a case study of a very successful family who had educated its younger generations in turn, and used the family foundation as a meeting point for them. The last one, from newer wealth, discussed how education was and was not being used in his family. A consensus emerged both among the panelists and in the audience that family education was one of the legs on which successful wealth management must rest. Two somewhat recent professional experiences made me realize that much work is still needed in this direction.

First off, I heard of and was subsequently exposed to a very wealthy family who suffered from its family office having failed on the family education dimension of its mission, having over-achieved on all of the others. This family indeed benefited from absolutely first-class asset management and estate planning. Its philanthropic activities appeared to be conducted in the most professional manner, with very active involvement of two members of the second generation. All other day-to-day aspects of family office management—bill paying and accounting for instance—also appeared to be executed virtually flawlessly. Yet, in the end, the family was in trouble and needed to make a decision for which they were totally unprepared. What was missing was the key element that superior wealth management always incorporates: family education.

The family had just been exposed to the notion that it may have been overspending. While the family office had, in the past, indicated that such might be the case, it had never done so in a manner to which the family could react; general comments were made, but rational expectations for investment returns were hardly discussed. One could argue that the leader of the family office acted in the role of a surrogate patriarch trying to shield the family from any of the challenges that having wealth typically brings. It is very hard to criticize that strategy, which was always motivated by a deep respect for the family and, to some extent, was a reaction to the family's preferring not to delve deeply into matters financial. But it's hard not to conclude that the lack of serious conversation on financial topics and the absence of a process to help family members

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develop skills for managing wealth creating a major headache for the family. Worse yet, the crisis contained the seeds of possible future family dislocation, as conflicts, which could be managed in a very united family, could eventually spin out of control.

This reminded me of another situation where a family was confronted with a challenge with the third generation. The family was relatively small in numbers if not financially. The second generation involved only two children, and there were only two grandchildren as well. At one point, one of the grandchildren expressed the desire not to be "troubled" with the business of managing the family's wealth. The grandchild wanted to "live a life that was like of his friends and schoolmates." The grandchild's parents could not find an effective way to help him realize that he had special duties and responsibilities, if for no other reason that he was accepting many of the benefits which come from being from a wealthy family.

Looking at the two families, and assuming that the attitude that had prevailed in the first case would have prevailed in the second as well, provides an instructive illustration of when family education is not an option—however attractive it might appear at times—but a duty.

The leader of the family office of the second family elected to deal with the grandchild and his parents, rather than to avoid the confrontation and let matters slide. He chose to tell them that being informed about and participating in the management of their wealth was one of their duties; after all, he noted, they did accept the benefits associated with being wealthy. Also, at one point, the first generation would pass and it would be necessary to have the second generation take over. He proposed that the family had two options. The first was to recognize that they are not like everyone else, and begin to take part in the management process. He pledged his unfailing support if they chose that option and indicated that he would do whatever it took to provide them with all the education they needed. The alternative was to add the wealth to the already substantial charitable foundation established by the first generation. That way, he said, they would not need to be concerned with the wealth—and they certainly would be like many other families! The patriarch was beaming during this exchange. He felt that if he had initiated the same conversation, he might alienate the grandchild, if not his parents. But he knew that a confrontation was absolutely necessary.

In our first family example, the leader of the office was also a first-class investor in his own right. He had known the family's first generation for most of his life, and saw their children almost as his own. He gave in to their initial reluctance to get involved. Even further, for the one or two that did wish to get involved, he seemed not to be prepared to simplify his own presentation style while remaining informative. He went from one extreme to the other, making it next to impossible for family members to learn. He did not seem to want to become informed on new trends or approaches in the private wealth management world, preferring the institutional approach he had used all along (with exceptional investment success). Ostensibly, he preferred the company of other first-class investors—whom he correctly saw as his investment management peers—rather than that of wealth managers, a few of whom would deal in "soft issues" which he felt were not that important.

Now, the family was coming to a crucial turning point. One of its advisers pointed out that its investment policy was unlikely to achieve its stated goals, unless one assumed that past success would remain the norm. The family's exceptional investment results were substantially a function of the family office having identified very early the trend toward alternative assets. This begged the obvious question: With that segment of the market maturing, would past results continue to prevail in the years ahead? The head of the family office himself thought not. More importantly, an external advisers suggested that should some adverse market development occur, the family would be exposed to the real risk that of changing horses in the middle of the race, thereby transforming short-term mark-to-market losses into permanent realized loss of capital.

As I was observing this dynamic, I could not help but feel pity for the family, the leader of the family office, and the external adviser. I am sure they all had the best of intentions, but theirs were cases of a succession of missed opportunities. Would they be able to compensate for them in the short term? Only time would tell.

From this case study, I learned three important lessons about managing family wealth:

a. Family education is absolutely crucial to a well-run family office. It should be inspired by the behavior of great parents. Family members should not be overwhelmed by technical information but a clear process should be formulated and implemented to ensure that maturity- and time-specific insights are provided through in a timely manner. It does not help a child for a parent to over-protect him or her. Neither does it help a family to be kept in the dark simply because it is trusting and not terribly interested.
b. Family education should first elicit each family member's needs, wants, wishes, and dreams as well as concerns, objections, fears, or nightmares. It is crucial to educate each family member about the links between their desires and aversions and the wealth they currently have or might have one day. This education must recognize issues relating to appropriate disclosures so as not to place undue burdens on each individual. (The advent and growth of goals-based wealth management greatly helps in this process. as it helps map assets to needs, wants, wishes, and dreams more effectively than a simple top -down return/risk utility-based portfolio optimization.)
c. Family education must capitalize on current events. Just as parenting is more effective in response to occasional questions rather than deliverd in lectures, education can use both positive and difficult events as teaching opportunities. Education will also help identify the wealth management areas for which each member is best suited.

Family education is not a luxury. It ensures that each generation is appropriately prepared to deal with the responsibilities associated with being wealthy and to make important decisions as required. Not only is education in a crisis unlikely to be successful—it can also expose the family to irreparable damage.

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The Fall 2013 issue of *The Journal of Wealth Management* starts with an article by Stephen Morison, David Lincoln, Benjamin Kinnard, and Zhi Ying Ng, which discusses three key trends in the world of ultrahigh -net -worth individuals and points to the increasing role of emerging countries in the creation of large personal fortunes.

The next two pieces share a strong relationship with financial planning and strategic asset allocation issues. The first, by Andrew Rudd and Laurence Siegel, focuses on the use of the household's economic balance sheet to help it conduct meaningful financial planning (expanding on an issue discussed here last quarter by Stephen Horan and Robert Johnson). The authors suggest that such a balance includes not only conventional accounting assets such as investments, but also the present value of expected pension and Social Security benefits and, most importantly, human capital (the present value of expected future earnings). The second article, by Javier Estrada, offers an international perspective on the relationship between risk and the holding period, confirming the well-understood notion that time does diversify risk.

The next two articles are also related to strategic asset allocation. Daniel Seiver and Samuel Frame focus on forecasting long-run equity market returns and show that a rarely researched valuation measure, the Value Line Median Appreciation Potential (MAP), also can be used to reliably forecast long-horizon stock market movements and to construct a portfolio superior to a buy-and-hold strategy. David Blanchett, Michael Finke, and Wade Pfau revisit the issue of sustainable withdrawal strategies taking into account current bond yields, with a model that allows them to "drift" toward a higher value during retirement using an autoregressive approach based primarily on historical relationships between asset classes.

Our next three articles relate to various aspects of the alternative asset world. The first, by Gaurav Anand, Iliya Kutsarov, Thomas Maier, and Marcus Storr, discusses the non-linear influence of macroeconomic factors, market factors, and behavioral factors on the performance of various hedge fund strategies and tactical strategy allocation for funds of hedge funds. The second, by Tom Arnold and John Earl, Jr., looks at the relationship between the

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liquidity of underlying assets and transparency, concluding that complete transparency is next to impossible to achieve with level 3 assets. Finally, Daniele Lamponi investigates empirically whether small CTAs are better than large ones and concludes that size does not seem to have prevented large funds from preserving the ability exploit the correlation across all assets, thus suggesting that large CTA funds appear to cope well with their size.

As usual, our last two articles cover important topics that fall outside of the natural flow of the other papers. The first, by Joachim Klement, James Greenrod, and Jay O'Neil, reviews the perceived over-allocation to Australian equities by Australian investors, where the usual home bias is compounded by the favorable tax treatment afforded to dividends and suggests that this strong preference for domestic equities can erode the wealth of Australian private investors over the long term, proposing an alternative optimal allocation to domestic equities for Australian investors. The last paper, by Stephen Horan, George Szundi, Edward Van Deman, and Kevin Whalen, focuses on helping family offices improve the management of their operations by offering a straightforward approach to understand, select, and use technology, eschewing the temptation to provide new technical results, electing instead to provide a framework to apply and internalize old lessons through a simple, clear process.

Jean L.P. Brunel
Editor