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The Journal *of*
Wealth Management

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ON THE COVER

Urchin 12
Hand-built stoneware, sgraffito, oxide stains, crackle slip, 2013
15 × 11 × 8 inches; 38.1 × 27.9 × 20.3 cm

***Melanie Ferguson** (American, born 1955) is a Georgia-based artist known for creating ceramics that encompass the profound influence of the ocean and it's surroundings, while exploring and enhancing the quality of hand-built form, and providing focus on atmospheric firing using stoneware or earthenware materials. The artist uses a coiling method reminiscent of tidal rhythm and flow allowing the ceramic to develop into its own unique form. Melanie Ferguson's works can be viewed in private, corporate, and museum collections, and are exhibited nationally and internationally. This piece and others by this artist are available through Cavin-Morris Gallery in New York City.*
Visit www.cavinmorris.com to view more works by this artist.

Over the years, numerous conversations have taken place with respect to the varied interactions between philanthropic and investment planning, and, by way of consequences, between philanthropic giving and investment management. Yet, as I was going through our issues back to the Journal's inception, I could not find more than a handful of articles discussing this in some depth. This is unfortunate, as the topic is incredibly rich and the interactions between philanthropic giving and asset management plentiful and not necessarily obvious. In fairness, at times, these interactions involve additional dimensions, such as estate planning or generational transfer.

Three main topics dominate the landscape: philanthropic giving can facilitate tax-efficient asset management; philanthropic planning can facilitate low basis stock diversification; philanthropic giving can facilitate long-term inter-generational asset transfers. Ostensibly, it is neither the mission nor even the place for such a topic—or variety of sub-topics—to be discussed in a letter from the editor. Yet, I thought it is well worth rekindling the fire somewhat in order to inspire potential authors to delve a bit more into the topic and submit articles that can enlighten our readers on this rich area.

Though not frequently discussed and yet almost intuitively obvious, the interaction between philanthropic giving and tax-efficient asset management is crucially important, and, more to the point, unlikely to become "obsolete" any time soon. In short, the idea is that giving substantially appreciated, but not necessarily concentrated, stock can help retain tax-aware portfolio management flexibility. The principal causal insight here is the well-known fact that tax-aware portfolio management tend to raise the market-to-book ratio of a portfolio; this results from the preference for taking unrealized capital losses, while allowing unrealized capital gains to run. Eventually, too high a market-to-book ratio will lead to portfolio freeze at which point no random market volatility will be sufficient to generate any capital loss that can be used to offset some gain elsewhere in the portfolio.

This is where philanthropic giving can come into the picture. Choosing to give appreciated securities can remove some of the highest unrealized capital gains and thus improve the manageability of the portfolio. The gain that is thus eliminated without being taken for tax purposes can come from one of two sources: it can be due to a specific security event, or it can be the result of some significant appreciation in the stocks of a particular industry. In the

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event the gain is security specific, one can optimize the resulting portfolio so that factor risks remain controlled. If it is industry specific, the use of some industry ETF can allow the portfolio to retain the desired exposure, provided care has been taken to avoid the pitfalls associated with straddle or constructive sale rules. Clearly, this process will involve both the giving away of some security or industry position and some additional portfolio activity, if only to raise the cash needed to replace the lost factor risks. Thus some careful planning is required, both prior to the transaction and even in some longer term time frame so that all relevant opportunities can be contemplated.

In contrast to the prior topic, much has been written and thus little additional is needed with respect to the use of charitable structures—such as Charitable Remainder Trusts, for instance—to diversify away from concentrated low basis, or sharply appreciated equity positions. In fact, a recent article published in the Journal even discussed the possible interaction between a CRT and pension accounts. However, given the constant evolution and the increasingly arcane nature of tax laws, one can only hope that prior literature can be updated to ensure that the principles which have been proposed actually still are feasible.

The interaction between philanthropy and generational planning is important and I could only find one article that discussed the topic, and it may well be somewhat dated. Charitable Lead Trusts do indeed offer interesting opportunities, particularly in periods where interest rates remain quite low. The principle is simple: a trust is set up that provides a grant to one or several charities for a fixed term of years, with whatever is left at the end of that period passing on to set beneficiaries. The key here is that the value of the eventual gift to the ultimate beneficiaries is calculated on the basis of some rate of return set by the IRS. When these are low and the family believes that it can earn more than that from the investments held in the trust, the excess return produces generational gifts which do not attract gift taxes.

Though this can be incredibly simple, it can also be made more complex and thus provide a means for the family to look at the structure not singularly, but as a part of its overall asset location. There, the family may choose to "locate" the riskier investment strategies within the CLT so that it maximizes the potential for some material residual to be available for future generations. Though the investment risk, within that structure, may thus be more elevated than what the family could tolerate in aggregate, the overall portfolio risk, when assessed across the aggregate portfolio can be managed down, for instance by having a lower than would otherwise be suggested risk profile there. Again, this requires significant planning and consideration of the various interactions, and certainly makes considerably more sense when the family already has charitable intentions. Considering both charitable and generational transfer goals simultaneously and jointly with investment allocation issues provides opportunities which are not necessarily available when one looks at each dimension independently.

In short, it would be my hope that authors might choose to spend some time to research and write more on this topic, which deserves more focus than has hitherto been afforded to it. While we are on the topic of philanthropy, it would also be nice if authors would consider looking at other interactions between philanthropy and the multiple disciplines associated with wealth management: the role of philanthropy in the education of future generations, or in the transfer of family values across generations would be two obvious topics. Broader interactions might concern issues such as impact or socially responsible investing, which we discussed in our last letter. Finally, it would also be useful for one to look into the limits associated with these very opportunities. Focusing for a minute on the transfer of family values, one would love to see an article discussing the benefits and disadvantages of injecting flexibility in the mandates of family foundations: should one "govern from the grave," or should one "provide a framework through which each generation sets its own priorities?

The Winter 2014 issue of *The Journal of Wealth Management* is the first in which we are publishing a few articles focused on the multi-family family offices of the future. We called for papers on this topic three months ago and are delighted that we can publish a couple already, with another few slated for our next two issues.

Our first two articles deal with this issue of the future of the family office industry, from two different perspectives. The first, by Kirby Rosplock and Barbara Hauser, presents an overview of the family office landscape and offer five predictions as to how it will evolve in the future. The second, by Michael Zeuner, Maria Elena Lagomasino, and

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Santiago Ulloa, takes a different tack, proposing a definition for a family office that is role- (not services-) based and discussing the different kinds of family office solutions available to wealthy families, how they can tell the differences, and why a traditional financial services company may not be able to provide a family office solution.

The next four articles form a heterogeneous group that belongs together in that they focus on different aspects of the wealth management challenge. The first, by Nicola Zanella, presents a broad and comprehensive guide to personal finance attempting to create a holistic approach to financial planning, managing the risks that could damage the different forms of individuals' wealth: mortality risk, liquidity risk, credit risk, property risk, standard of living risk, and aspirational risk. The second, by Jos Rath and Theo Schuyt, discusses a "market approach" to philanthropy, which they describe as "entrepreneurial philanthropy," offering both an introduction to the concept and its features. The third article in this group is by John Haslem and has a particular relevance to family education in that it focuses on financial literacy, which has become a major area of research in recent years, both in the investment and retirement literature with respect to the increasing complexity of financial products and need to save for retirement. Studies generally find individuals are financially uninformed and lacking in basic financial principles. The fourth, by Parvez Ahmed and Donald Wiggins, looks into the issue of blockage discounts in the valuation of equity positions in the context of estates or divorce settlements, exploring the plausibility of any discount arising from unusually large trading volume and explaining a hedging strategy that could mitigate the adverse effect of any blockage discount, if one was presumed to exist.

The next four articles are more directly focused on asset management, with the first two discussing risk issues and the next two investment vehicle topics. The first, by Franklin Parker, proposes an alternate paradigm for quantifying downside risk for the retail investor, to provide concrete tools to the retail financial advisor and investor which can be used to understand portfolio risks within a financial planning context. The second, by Javier Estrada, expands on an earlier paper inviting readers to rethink risk and focuses on the small versus large cap, and growth versus value stock traditional risk evaluation, concluding that small stocks should be viewed as less risky than large stocks, and value stocks as less risky than growth stocks, because small and value stocks offer both more upside potential and, when tail risks strike, better downside protection than do large and growth stocks. The first of the two of the articles looking at investment vehicles is by Panagiotis Schizas and focuses on a relatively new development, actively managed ETFs, comparing them with alternative investment solutions such as passive ETFs, mutual funds and hedge funds and concluding that active ETFs are not as active as they are considered by market participants. The last article in this group, by Mark Schaub, looks at non-U.S. ADRs and compares the performance of IPO versus SEO issues in two periods (the 1990s and the 2000s), concluding that there is a significant period dependency and contrasting results in the emerging and developed worlds.

Our penultimate article is by frequent contributor Olivier Mesly and explains how competitive advantage can be achieved by one producer to the detriment of another producer using the Consolidated Model of Financial Predation (CMFP). The article shows that regulatory authorities can identify those responsible for the 2008 market chaos by identifying those who provoked and sustained asymmetry of information to their advantage with the purpose of causing harm to the other market agents, by surprise.

Our final article, as has become our custom, is a book review. Jean Brunel reviews Charlotte B. Beyer's recent book, entitled *Wealth Management Unwrapped: Unwrap What You Need to Know and Enjoy the Present*.

Jean L.P. Brunel
Editor

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