THE JOURNAL OF
WEALTH MANAGEMENT

VOLUME 3, NUMBER 3 WINTER 2000

One of the most interesting trends one can currently observe developing in the wealth management world seems to be the integration of all planning disciplines into one effort, which can be called integrated wealth planning. There have long been very qualified experts with respect to financial planning, estate planning or investment planning, the latter focused on strategic asset allocation and more recently on asset location as well. Yet, each of these disciplines has tended to evolve individually without as much integration as one might think would make sense.

It is becoming increasingly clear that the real opportunity for wealthy investors is to identify the interactions among these disciplines and capitalize on the multitude of opportunities that creates. The emerging focus on asset location is one simple example of such interactions. The relevant insight is that different "pockets" offer, among other attributes, different opportunities to manage overall portfolio tax efficiency. Important questions would include: Which pocket should hold my most tax-inefficient strategies? Should the portfolio hold taxable or tax-exempt fixed-income (taxable bonds in the tax-exempt pocket or tax-exempt bonds in the taxable pocket)? Is a tax-efficient equity portfolio more appropriate than a tax-inefficient alternative, given the location choices available?

That debate, only begins to scratch the surface. In fact, one can imagine a different objective, one focused on the concept of *dynamic asset location*. Rather than viewing the asset location decision as a one-time event, it is in fact an element of continuous focus. This can apply in at least two different circumstances.

Periodic portfolio rebalancing. Portfolio rebalancing when the capital market line has a positive slope (i.e., capital market returns are positive) requires the realization of capital gains. Periodic portfolio rebalancing in a taxable portfolio thus exposes the assets to a capital gains tax drag. The potential benefits associated with the rebalancing (risk control or return enhancement) must be balanced against the certainty associated with the realization of capital gains and the payment of associated capital gains taxes.

Thus, an optimal strategy might be to structure the initial strategic asset location with the view that the tax-exempt (or tax-deferred) pockets will be used as a form of a completion portfolio for

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one's whole wealth. Portfolio rebalancing would be carried out in the tax-exempt or tax-deferred pockets so as to affect the overall asset allocation.

Transactions with income tax-defective trusts. Some trusts are effective from an estate tax standpoint, but defective from an income tax perspective. This creates a number of potential opportunities if the appropriate language is incorporated in the governing instrument. Four examples might serve to illustrate both the opportunity and to offer research agendas for potential authors.

Reducing the forward-looking volatility of a successful GRAT (Grantor Retained Annuity Trust). Imagine that a stock placed in a GRAT has appreciated so substantially as to satisfy the grantor's gifting wishes. Further, that stock is perceived to be still attractive, but too risky or volatile to keep in the GRAT. The grantor may exchange that stock for some other, less risky security, without triggering any capital gain. This can lock in the appreciation to date in the GRAT and provide the grantor with an opportunity for further appreciation in that stock, both without triggering capital gains realizations.

Capturing the appreciation potential of a depressed, attractive, security. Imagine a low-basis security is placed in a GRAT. Contrary to expectations, the security's price does not appreciate, but falls, but the grantor still believes there is value in the security. Even if the stock should rise from that point forward, the GRAT may well not experience sufficient returns over its full time horizon for there to be a significant (if any) amount accruing to the remaindermen when the GRAT matures.

One could consider exchanging that stock for some other less volatile security in the original GRAT and creating a new GRAT into which the original security is now be placed at the new lower market value. This would create an opportunity for there to be significant "excess returns" within the new GRAT, thus providing a tax-free gift to the remaindermen.

Capturing total portfolio tax efficiencies outside the GRAT. Imagine a security is bought within a GRAT and that the price of that stock goes down, creating an unrealized capital loss. Further imagine that there are other stocks in the GRAT whose prices have gone up. Because the grantor typically pays income taxes (effectively providing the remaindermen with an economic benefit that has certain of the aspects of a gift), it may not be beneficial for the management of the GRAT to focus

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on minimizing net realized capital gains within the GRAT. It might make sense to take gains within the GRAT when they arise and transfer out of the GRAT significantly depreciated securities, so that losses are taken outside the GRAT.

In short, the grantor may exchange the depreciated security and sell it outside the GRAT, thus harvesting the loss in order to optimize the tax position outside the GRAT. This provides an opportunity for grantors to enhance the tax efficiency of their overall wealth management efforts, while maximize the gifting potential of the GRAT.

Reducing potential capital gains for GRAT remaindermen. Finally, suppose that, close to the time a GRAT is scheduled to mature, the grantor observes that a security has appreciated substantially. If it is allowed to remain in the GRAT until maturity, that security would pass on (in part) to remaindermen at its original tax basis, exposing them to capital gains taxes should they elect to sell it after having received it. The grantor may, if it is allowed in the trust document, elect to exchange that appreciated stock, taking it back into its own portfolio, and replace it in the GRAT with a like-value alternative, without realizing capital gains. This would save the potential capital gains liability for remaindermen, while the appreciated security taken back into the grantor's portfolio can become a part of the grantor's estate and benefit from the step-up in basis as and when the estate matures.

In short, dynamic asset location has great potential for further research to evaluate the interactions among estate, financial, and investment planning. Papers on this topic are actively solicited.

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The first two articles in the Winter 2000 issue deal with general equity market circumstances. John Shoven and Clemens Sialm focus on the flaws inherent in the Dow Jones Industrial Average index and evaluate the implications of fixing these flaws. Victor Canto looks at recent market activity to make the point that certain analytical tools can produce materially misleading conclusions.

The next three articles focus on structural issues. Leslie Kiefer discuss broad diversification strategies available to investors with concentrated low-tax basis positions. Bruce Paulson and Gregory Owens

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discuss the economics of charitable remainder trusts and the related asset management issues. John Spitzer and Sandeep Singh compare five retirement saving choices, and suggest that employer matching plans are usually but not always the most beneficial alternative for maximizing post-retirement accumulations.

Then, Mark Anson discusses the selection of hedge fund managers, addressing some practical issues to consider in establishing a hedge fund investment program. Ai-Lin Chen and Mike Seiler explore the important issue of the impact of taxes on mutual fund rankings, concluding that the evidence supports the view that they do not . Finally, Brunel introduces two possible approaches to constructing meaningful after-tax performance benchmarks, borrowing from the experience of the private equity industry.

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