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As we embark into the third Millenium, let me offer all of our readers our best wishes for a happy and prosperous year 2001. The year 2000 proved to be a very good year for the Journal. Thanks to growing support by the members of our Advisory Board and many authors, we were able to publish 15% more articles comprising almost 20% more text. Clearly, numbers only tell a very small part of the story, as our purpose is not to publish as many long articles as we can, but rather to publish as many great papers as possible. In that context, the flow of unsolicited articles improved significantly and this is very gratifying. Also, we were delighted to see a substantially greater interest in our Journal by members of the academic community, an important trend as their research is of critical importance to the full study of so many of the new issues associated with tax-efficient wealth management across generations. Let me reiterate the often-made plea: keep all these submissions flowing!

* * *

One of the thoughts that keep me excited about the asset management industry is the idea that we are now in the early stages of the second real revolution. Peter Bernstein provided a fascinating chronicle of the entrée of academia into the world of investment management in his book entitled *Capital Ideas*. Arguably, the most important insight arising from the observation of the period starting in the late 1960s and ending in the late 1980s is the extent to which the asset management industry was changed by the advent of Modern Portfolio Theory and the requirements imposed by ERISA. In short, the change probably relates to the fact that the investment problem acquired another dimension. It moved from being a one-dimensional issue, with a sharp focus on return, to being analyzed into the two dimensions of return *and* risk. The changes that this wrought in the asset management industry are all well known. They include the birth and explosive growth of the investment consulting industry, the "discovery" of numerous new asset classes, the product proliferation phenomenon, and the fragmentation of the asset management industry.

I am sure I have not been the only one arguing that the last several years marked the onset of the second major revolution. The shift in the control of investment assets, from dominance by institutions to

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an ever-increasing role by individuals is forcing our industry to recognize the importance of tax-efficiency. Indeed, though many individuals still hold their financial assets in tax-deferred vehicles, a growing plurality has built significant taxable portfolios, helped in that process by the strong bull market of the late 1990s. This is moving the investment problem from the two dimensions it acquired over the last 30 years to a three-dimensional space, with the third new dimension being tax-efficiency. What good is it to anyone to generate higher pretax returns if this does not translate into higher after-tax wealth? The first area of impact has been the traditional investment process, which now more commonly incorporates some focus on tax-efficiency, although there are still a number of investment managers who do not totally understand the full implications of being tax-efficient. The next frontier relates to the need to incorporate both income and transfer tax issues into the equation.

Though it will probably be a while before everyone can clearly see the full effect of the changes that this second revolution will cause in the asset-management industry, it is not unreasonable to speculate on three possible areas of change:

1. *A different role for portfolio managers*. Adam Smith would probably observe that the role of private asset managers has evolved in a direction that did not parallel institutional portfolio managers because client needs were different, even if not always clearly articulated. The greater attention paid to developing a solid understanding of the different needs of individuals and the effort expended to formulate customized solutions will likely lead to a very different role for private portfolio managers going forward. I expect only a small number of portfolio managers to keep focusing on security selection issues, and, in that role, to mirror the activities of their institutional counterparts. By contrast, I would not be surprised if the large majority of private portfolio managers saw the market require them to become much more adept at two tasks. First, they will need to customize each individual portfolio so that each such portfolio captures as much of the security selection insights as compatible with their starting portfolio constraints. Second, they will need to be able to explain their strategy in clear and jargon-free language.

With the growing ability of technology to help us become more productive and efficient, it is not hard to imagine those twin tasks rely-

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ing more and more on technology. Efficient and profitable individual portfolio customization is made possible by expert systems, which can analyze the multitude of possible transaction alternatives and recommend those that make sense in the specific circumstances of each portfolio. Enhanced, customized, and timely communication is made possible by the interactive capabilities available through an Internet delivery of individual portfolio reporting, whether those capabilities are tapped directly by each investor or by a portfolio manager who in turn would make the customized output available to each client.

2. *A growing partnership between asset and fiduciary management*. In many ways, one could argue that this is really nothing more than a return to the past. Indeed, the service model historically applied to the individual investor world involved a Siamese twin approach to the delivery of portfolio management and trust administration. The increasing need for sophisticated investment solutions has somewhat altered that relationship, with the roles of portfolio and fiduciary managers diverging somewhat. Many private asset management firms have consequently evolved the fiduciary management function closer to a business development role. Yet, I believe that the increasing attention paid to asset location issues may well take us back to that original interaction between fiduciary and portfolio managers. Portfolio management, and trust administration are both becoming more complex and sophisticated. Dynamic asset location, for instance, is placing an increased burden on trust administrators who need to be more intimately involved in the continuing interaction between investment and estate planning issues, and take substantially more proactive stances.

3. *A need for overall coordination*. The need to consider total portfolio issues and to work on a simultaneous (rather than sequential) portfolio optimization creates a role that has hitherto been played by many individuals in an uneven fashion. Total after-tax wealth management requires someone, afforded total access to the full picture, to be able to direct the working of the full orchestra helping the client. Without such an individual, who is responsible for current income tax-efficiency coordination and management across multiple pockets and in a multimanager stable? For periodic tax-efficient portfolio rebalancing decisions? For capturing the opportunities for dynamic asset location? Arguably, for

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those dealing with great wealth, a family office plays that role, whether it is dedicated to a single family or to multiple families. However, when dealing with lower overall levels of wealth, it may not be practical for there to be a dedicated resource, yet the need persists. Though each of the three main generic providers of services to the wealthy (private banks, independent asset managers, and master custodians) will probably evolve a role based on their own leading competencies, one cannot help but dream of an alternative. My own dream revolves around the idea of a dedicated advisor, working within any service provider, but willing and able to think in open architecture terms. Indeed, if it is true that investors need choice and that no one has the monopoly on brains, then it must follow that the winner will have to be able to offer both proprietary and non-proprietary solutions to his or her clients.

* * *

In this issue, we cover a wide diversity of topics, which can be broadly classified into three groups. The first three articles deal with various aspects of investment selection. We start with an article by Robert Arnott, Andrew Berkin, and Jia Ye, which addresses the question of the value of loss harvesting. Interestingly, though the experiments are designed somewhat differently, their conclusions are remarkably consistent with those offered in the Fall 1999 issue of our Journal by David Stein and Premkumar Narasimhan. We stay on the topic of portfolio management with an article by Mun Sim Lai and Michael Seiler, who focus on the issue of portfolio diversification and quantify the costs associated with excessive concentration. The third article is authored by Stan Beckers and Michael Suen, who evaluate the Morningstar star ratings as a selection criterion and explore whether other fund characteristics can improve the forecasting accuracy.

We next turn to the issue of strategic asset location with two articles. The first, by Lawrence Macklin provides insightful comments on dynasty trusts, an estate planning technique that offers both planning and execution benefits. In particular, many very wealthy families appreciate the fact that they change the nature of the assets transferred to future generations. Heirs become "stewards" for, rather than "users" of, the family's wealth. Frank Caliendo, Cris Lewis, and Tyler Bowles look into strategic IRA investing and take an unusual approach, the first that I have seen. They consider the relative bene-

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fits of traditional and Roth IRAs, but do so assuming that the investor also invests through a taxable pocket.

The final three articles focus on detailed investment issues. The first, by Robert Johnson, Frank Reilly, and David Wright discusses the interest sensitivity of a mixed asset portfolio. This provides the authors with an opportunity to review issues related to the duration of equities, an important topic. The second, by Robert Johnson, Gerald Jensen, and Jeffrey Mercer discusses a similar issue, but with a focus more sharply placed on differences in the sensitivity to interest rates of individual industries. Finally, the article by Rarin Tejapaibul and Michael Seiler looks into an issue that has recently become quite topical: they investigate the relationship between extended-hours trading and trading during the regular period and conclude that the convenience benefits derived from being able to execute trades after-hours are outweighed by the added risk.

* * *

I would like to conclude by welcoming two new members to our Advisory Board. Robert Gordon, President of Twenty-First Securities Corporation has been a leading advocate of the use of derivatives in promoting tax-efficiency. Robert Johnson, Senior Vice President of the Association for Investment Management and Research has already contributed to the Journal, both as an author and a reviewer. Both will further strengthen us and thus help us better achieve our goal to serve as the premier forum to explore investment management issues relevant to individual investors.

Jean L.P. Brunel
Editor

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