

# WEALTH MANAGEMENT

VOLUME 4, NUMBER 2

FALL 2001

JEAN L.P. BRUNEL Editor

HARRY KATZ Production Director

PEGGY MALONE Production Supervisor

MICHELLE WRIGHT Senior Production Artist

DAVID GOMBAC Copyeditor

AJANI MALIK Reprints Manager

GEORGE LIAO Circulation Director

INGRID BONEY Marketing Manager

STEFANNY HSU Senior Marketing Associate

JOHN POLEK Web Customer Service  
Coordinator

MARYANN ARMOND Account Manager

MICHAEL SHAW Account Manager

TAMMY MARTINEZ Advertising Assistant

ALEX BELINSKY Fulfillment Director

CHERLY-NINA BONNY Fulfillment Supervisor

KATHY COMMISSO Fulfillment Assistant

NASHELLE ORTIZ Fulfillment Assistant

JESSICA REID Group Finance Manager

CLAUDIA MYERS Accounts Manager

GREG ANDERSON COO

ALLISON ADAMS Publisher

CHRIS BROWN CEO

Attending a conference focused on family office issues, I had the pleasure of meeting in person one of the contributors to this issue of *The Journal of Wealth Management*, Barbara Hauser. What made that encounter special is the fact that we had an opportunity to discuss one of the issues which seem to be of concern to most affluent families: the interaction between money, wealth, and the development of healthy children, with health being understood as covering both mind and body. Barbara Hauser introduced me to Suzan Peterfreund with whom she authored a recently published the short book entitled: *Mommy, Are We Rich? Talking to Children about Family Money*.\*

The real or perceived interactions between wealth and the personal development of children have been chronicled in numerous places. The most frequently heard message is often somewhat pessimistic. A quote from Andrew Carnegie (“Wealth,” *North American Review*, 148, no. 391 [June 1889], pp. 653, 657-662) illustrates this severe vision of the risks associated with wealth (emphasis added):

This, then, is held to be the duty of the man of Wealth: First, to set an example of modest, unostentatious living, shunning display or extravagance; *to provide moderately for the legitimate wants of those dependent upon him*; and after doing so to consider all surplus revenues which come to him simply as trust funds, which he is called upon to administer, and strictly bound as a matter of duty to administer in the manner which, in his judgment, is best calculated to produce the most beneficial result for the community—the man of wealth thus becoming the sole agent and trustee for his poorer brethren, bringing to their service his superior wisdom, experience, and ability to administer—doing for them better than they would or could do for themselves.

Money is viewed as carrying a high risk of “spoiling children,” of “preventing them developing as full contributors to society,” or of “diverting their personal motivation toward idle pursuits.”

It should not surprise that instruments have developed to deal with these perceptions. Incentive trusts, which attracted substantial press coverage over the last few years, are a perfect example. They are designed to “reward” the beneficiaries of the trust when they achieve

THE JOURNAL OF  
**WEALTH  
MANAGEMENT**

certain milestones. For instance, the payout from the trust may double when they graduate from college, double again when they receive an advanced degree, or provide for funds matching the income they earn from non-family sources.

Hauser and Peterfreund tend to take a virtually opposite stance on the issue. They argue that money and wealth, far from being a potential scourge, can be made to work toward the development of children. The book starts with a note the U.S. culture is at least somewhat confused and ambivalent about money. Money is one of the means through which individuals “keep score,” and yet it is also viewed as something evil, as it can lead to idleness, which the Puritans knew as “the work of the devil.” The book proceeds through a number of very simple questions and quotes by young children to make the case for a balanced approach toward child development, and, in fact, life in general. The authors work to distinguish between the hidden meaning that adults might seek in these questions and the often naïve real purpose of the child’s question.

In the end, their ultimate view is simply that money should be perceived as an “enabler.” The child whose goal and happiness in life will best be met by working in a traditional sense should be encouraged to do so. At the same time, they would also suggest that a family fortune can help children dedicate their lives to pursuits which our society currently does not reward in monetary terms, without feeling that they will need to give up a way of living that they might feel desirable. One of the simplest, and most telling, questions in the book is: “How much does a ballerina get?” The question is asked by a young girl in response to a query as to whether she might have a lot of money when she grows up. The authors suggest that the traditional framework in which “money is the important scorecard” and where “traditional work-for-money is the only recognized path to success” is too constraining. Thus, they would probably object to incentive trusts, in effect accusing these tools of trying to impose the values and motivations of one generation on another.

One topic which is not covered and deserves further attention is found both in the quote by Andrew Carnegie and in the day-to-day behavior of a few wealthy families today. How can wealthy families best develop in their younger generations the notion that they should be the “stewards of the family fortunes for future generations” rather than the users of that wealth? This is a critical distinction. As a steward of the family’s fortune, the objective seemingly should be to use that wealth in a way which accomplishes three important goals: first, to protect and in fact enhance the reputation of the family as a responsible contributor to society; second, to protect and in fact promote the nurturing of family values across an ever growing number of members; and third, to protect and in fact grow the purchasing power of that wealth, in a way that recognizes the fact that, over time, the number of individuals calling upon that wealth will expand exponentially.

THE JOURNAL OF  
**WEALTH  
MANAGEMENT**

\* \* \*

This Fall 2001 Issue of *The Journal of Wealth Management* is principally focused on portfolio construction and asset allocation and tax-efficient security selection, but also comprises three very interesting articles on foundation and family office management.

The first article is by Kathryn McCarthy and explores the investment challenges faced by foundations, with a specific focus on selecting and hiring managers to handle these financial assets. Barbara Hauser offers insights into the development of family offices in the U.S. and suggests that many may have in fact somewhat lost their ways. She therefore proposes a prototype which might also be adapted to other countries where similar needs exist. The third article is by Jon Carroll and focuses on the diverse functions, benefits, and costs of a family office.

The next four articles relate to the critical question of asset allocation and portfolio construction. Cris Lewis and Tyler Bowles look at the effect of income taxes on optimal portfolio selection, and conclude that failure to consider progressive taxes will usually lead to an excessively large commitment to equities. David Stein addresses the issue of the optimal structure and design of an equity portfolio in the presence of taxes, suggesting that investors might be better served with a total portfolio focus. Jean Brunel arrives at a similar conclusion, but through a different path, investigating the relationship between portfolio activity and tax efficiency and proposing a barbell core and satellite approach. John Mulvey, Nan Lu, and Jon Sweemer discuss rebalancing strategies for multi-period asset allocation, focusing on circumstances where some of the portfolio is invested in alternative assets. They show the intrinsic advantages of a multi-period asset allocation strategy and present an optimizing approach for addressing transaction costs.

In the final article, we return to the question of individual security management. Robert Gordon and Jan Rosen look into the various ways in which one can benefit from the random volatility of capital markets, through loss harvesting. Starting with a premise recalling the work of Stein and Narasimhan [1999] or Arnott, Berkin, and Ye [2001] that loss harvesting should be a year-round activity, they present strategies suited to different circumstances.

**Jean L.P. Brunel**  
**Editor**

**ENDNOTE**

\*Published in 2001 by Mesatop Press, Box 398, Rochester, MN 55903.