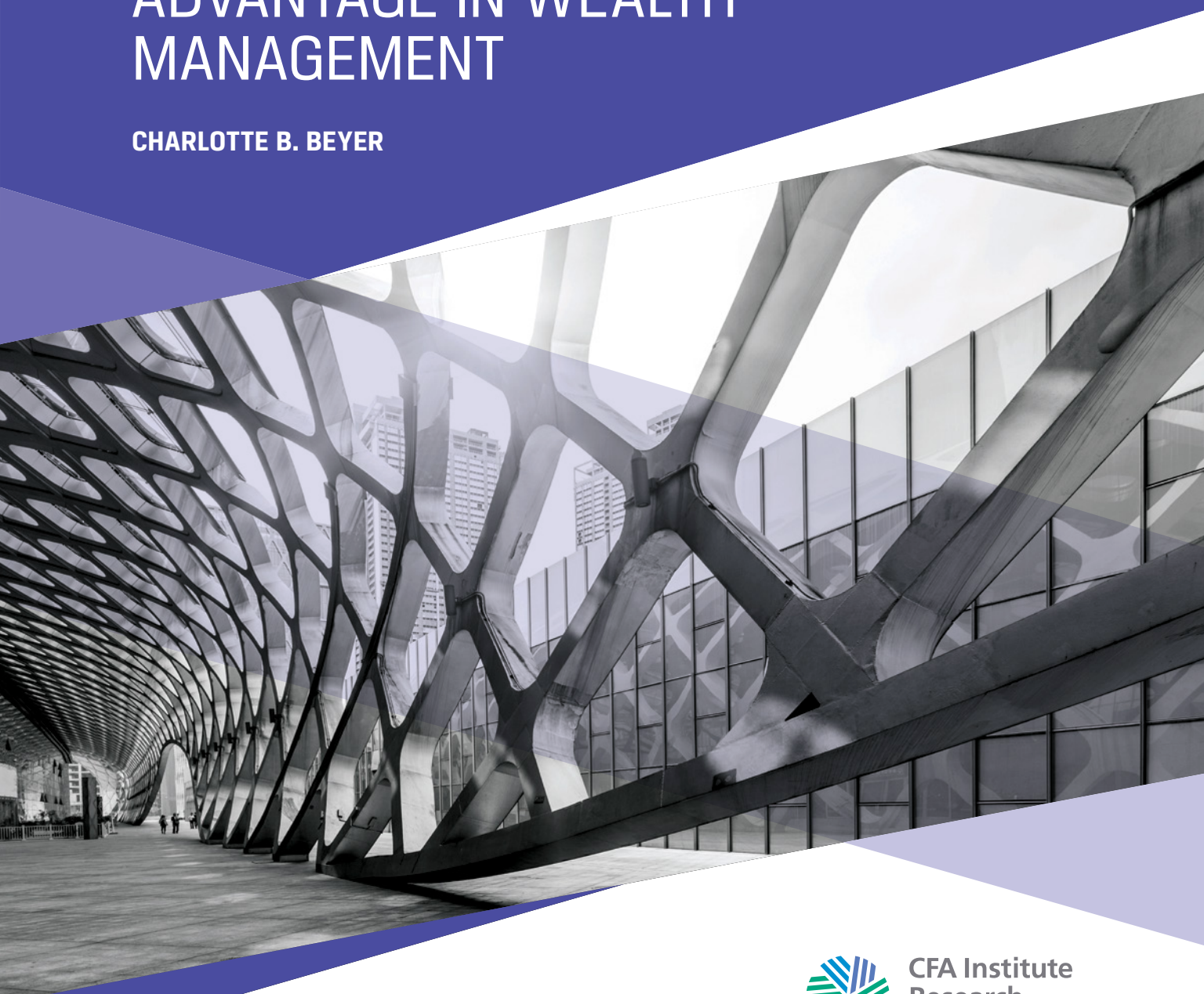


CFA INSTITUTE RESEARCH FOUNDATION / BRIEF

RELATIONSHIP ALPHA: THE EMERGING COMPETITIVE ADVANTAGE IN WEALTH MANAGEMENT

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CFA Institute
Research
Foundation

RELATIONSHIP ALPHA

The Emerging Competitive Advantage in Wealth Management

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RELATIONSHIP ALPHA: THE EMERGING COMPETITIVE ADVANTAGE IN WEALTH MANAGEMENT

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The new measure of relationship alpha (α) can result in a more profitable wealth management firm with higher client retention and greater success in growing assets. CFA Institute publishes a rich trove of material on wealth management and professional standards. Those who strive to serve private clients in an ethical and professional manner depend on these publications to guide their firms and their own conduct. What has been missing until now is an explanation and description of relationship α . This brief can assist investment professionals as they work to address the intangible and perplexing aspects of the relationship between client and advisor. This brief presents a set of new behaviors that can build relationship α .

THE ORIGINAL INSPIRATION

After 20 years on Wall Street selling to high-net-worth (HNW) individuals, I began to see how information asymmetry hurt both investors and the industry as a whole. The sales model was broken; no one dared adjust the typical 50-page PowerPoint presentation. Gaining new assets was deemed far more critical than asking searching questions of the prospect. By the early 1990s,

I was convinced that more investor education could help both the advisor and the investor, so I founded a very different kind of company. Its mission was identical to the purpose of this brief—namely, to change the way investors work with advisors and advisors work with investors for the benefit of both.

That entrepreneurial venture in 1991 offered no product and sold no advice. The sole mission was to provide a safe harbor—an educational community for investors and advisors. The goal of every event was to create a more informed consumer of financial services. If education is engaging and experiential and if candor is the norm, investors benefit enormously—and so do their advisors, who are able to work more seamlessly with their clients. Both can win, and relationship α increases. But here in investors' own words are what professionals encounter:

“I can easily find people to manage my money; they're a dime a dozen.”

—UHNW investor

“Money managers all sound the same. I could do their presentations in my sleep.”

—UHNW investor

The commoditization of asset management is not news; it’s here, eroding profit margins and challenging small and large firms alike. Products and services are so commonplace and described with such clichés by most firms that, as with any commodity, private clients tend to choose based on price. Speeding up this commoditization is the popular trend toward lower-cost exchange-traded funds (ETFs) and other passive, rules-based funds. Without differentiation in the eyes of the consumer, firms will struggle to grow assets. To adapt, they must discover how to set themselves apart from what investors see as a cliché-ridden commodity.

When young people first enter the wealth management industry, the leap from book knowledge to actual skills in practice is not easy. New investment professionals especially will gain an advantage by grasping these new concepts and practicing new behaviors, often referred to as soft skills, in their interactions with both clients and prospects. Relationship α is more than soft skills; however, it encompasses all facets of wealth management. For example, private clients who complain when a firm ignores taxes will appreciate taxes being brought up for discussion even if the tax expertise is not in house.

The opportunity to differentiate a firm will come from these younger professionals.

Once fully trained in new behaviors, they will produce relationship α by approaching each client relationship in original and impactful ways.

HIRED (OR NOT) BECAUSE OF RELATIONSHIP α

Despite the enormous wealth transfer and sheer number of wealthy investors, professionals often flounder in new business presentations by sounding scripted or, worse, disingenuous. Client meetings are still monopolized by the firm’s investment professionals and are often quite boring, according to private clients. By putting too much emphasis on investment management, the industry misses an opportunity to meet more critical client needs and expectations. A distinctly different approach is emerging, one that addresses how to improve the client relationship and enhance outcomes for the entire family. This new approach acknowledges the interdependence of eight distinct components of wealth management, as illustrated in **Figure 1**.

Even after recognizing that wealth management is multi-faceted, however, some professionals will overemphasize investment management and fail to address critical variables in a family’s situation. Even worse, too eager to impress a prospect, some firms may profess expertise in every one of the eight wealth management components.

As André Gide remarked, “Everything that needs to be said has already been said. But since no one was listening, everything must be said again.”¹ To see clearly what is

FIGURE 1. EIGHT COMPONENTS OF WEALTH MANAGEMENT



happening today, we need to look back to the late 1980s and early 1990s. After the dismaying lack of movement in the stock market for almost two decades (from 1965 to 1982, the market was basically flat), stocks began their stunning comeback. The stock market soon became the United States’ favorite hobby. Do-it-yourselfers were lured by discount brokerage firms, and mutual funds embarked on a dizzying growth period.

The wealthiest individuals began to dismiss bank trust departments as too sleepy

and began looking for what they deemed superior, institutional-caliber asset managers. From 8–9 October 1992 in Chicago, AIMR and the ICFA hosted the “Investment Counsel for Private Clients” conference.² This inaugural HNW investment conference was attended by more than 200 professionals and CFA charterholders. The M&A activity of the late 1980s was slowly but surely being recognized as a huge opportunity for asset managers. Specializing in private client money management had previously been considered trust company

purview and not easily scaled because of what were assumed to be burdensome and costly client service demands. At that conference more than 25 years ago, I debunked seven myths about the private client market. These same false beliefs persist today, however, so it's as if I'd written the following yesterday:³

Myth 1: Performance is not important. I have yet to hear anyone say he or she hired a manager despite the manager's questionable investment track record. Private clients want advisors to do a good job, and that means performance. Of course, good performance for one client may not be good performance for another. Good performance should be defined in terms of time frames, inflation, willingness to lose money in a given year or quarter, and particularly tax sensitivity. Yet few advisors ask clients about these parameters. Clients want to beat the S&P 500, but how will they feel if the S&P 500 is down 12 percent and the advisor beats the S&P 500 by being down 7 percent? Some advisors pick a point on the efficient frontier to identify their clients' risk tolerance. That is like taking driving classes but never leaving the classroom to drive on the road. One way to get at their actual risk tolerance is to layout each scenario precisely,

perhaps using a matrix to show real dollars gained or lost in varying market conditions and with varying asset allocation mixes. This is how you discover a client's real comfort level. Why do so few managers do this? Because most believe they do not have to.

Myth 2: The private client market is less competitive than the institutional market. The high-net-worth market is far more competitive than anybody ever imagined. The United States has more than 20,000 registered investment advisors today,⁴ compared with fewer than 6,000 in 1980. Many of the 80,000-plus brokers in the United States sell exactly what the advisors do—peace of mind that comes from knowing an expert is interested in and capable of managing a client's assets. Brokers are teaching clients the meaning of words like “risk-return trade-off” and “benchmarks.” Many advisors are not doing this, however, because they believe client education is unnecessary.

Myth 3: The private client market is not as demanding as the institutional market. Consider the following example of the demands encountered in the high-net-worth market: Three investment firms were asked to

make a presentation to a couple who had recently established a charitable remainder annuity trust with a 10 percent payout (in a 3 percent interest rate environment) that had been drawn up by a trusted personal advisor to the family, an accountant/attorney. Should the investment advisors mention the unrealistic payout? Should they describe the risk of meeting such a payout or merely explain how they would manage that portfolio with that goal in mind?

Myth 4: Service is more important than anything else. If an advisor clings to this idea, the organization is probably burdened with too many people responding to too many unreasonable and irrational requests. Many advisors believe they must spend a lot of time talking with their clients, entertaining them, and asking about the children or the summer houses. They do not spend enough time uncovering specific investment objectives.

Myth 5: The private client market is unsophisticated. Few advisors realize how sophisticated the private client has become. The pension industry has a common language—risk, return, volatility, variability, portfolio characteristics, and so forth. Advisors to private clients

seldom bother to explain these terms to their clients because they assume their clients are not interested in all this. Even if they are not interested today, they will be soon. One day, an accountant or attorney will ask, “What benchmark should we use to evaluate your performance?” Few investment firms place genuine emphasis on (and even fewer insist on) a specific and complete investment policy document. Sophisticated private clients now demand it, and the less sophisticated will benefit from it. The client and advisor can avoid the constant tinkering with the portfolio, for which the advisor may end up getting fired because he listened too well to the client. Included in this document are investment objectives, benchmarks, investment constraints, and guidelines. Within what range of asset allocation should the manager stay? Does the client want fully invested positions, or is the allocation to cash left to the discretion of the manager? How often will portfolio evaluation take place? What if the first-quarter performance is dismal? What if the first year’s performance is dismal?

Myth 6: Risk tolerance and other investor characteristics change as asset size changes. A more

crucial factor than asset size is investor personality. You need to know a client's personality more urgently than you need to know the size of the assets or how he made the money.

Myth 7: The private client market is just like the ERISA market in the early 1970s. The individual market is not like the institutional market of the early 1970s, when the Employee Retirement Income Security Act (ERISA) was enacted. At that time, the institutional market had actuarial or pension consultants who guided plan sponsors in various investment directions. They held the sponsor's hand in those early days when sponsors were not very sophisticated and were just learning. No such organized or well-informed profession exists today to guide the private client, but brokers, accountants, attorneys, and financial planners are all scrambling to learn as much as they can about asset management. The role of the intermediary in the private investor market is evolving at breakneck speed.

"Recent developments" I cited 25 years ago also sound eerily familiar today. Both periods experienced high returns, and expectations are even higher in 2019. Likewise, the following concerns I raised in that 1992

conference presentation are just as worrisome today:

The returns of the 1980s were staggering and created a dramatically different environment for advisors. Private clients now expect 12 or 13 percent annual returns for a balanced fund and 25 or even 40 percent as a reasonable annual stock market return. Many people remember only recent history, so an advisor has the formidable task of being a historian. Events such as marriage, health, aging, and shifts in the economy all have an impact on the psyche and, ultimately, on client expectations, which are crucial. Brokers' wrap fees are the single greatest change to occur in the marketplace. *Forbes* magazine may call them "rip fees," but the wrap fee business is exploding. Hundreds of new accounts are being opened daily by virtually every brokerage firm across the United States, and the pace shows no signs of slowing. Brokers are counseling on investment objectives, time horizons, and risk tolerance. The more skilled the brokers become, the bigger threat they are to the investment management business, unless the manager is in one of their programs or is a superior counselor.

Another change is the spotlight press attention. Magazines as varied as *Town & Country* and *Vogue* have articles on managing personal finances. Every day, the *Wall Street Journal* and other periodicals have score cards on mutual funds. They carry contests for investment advisors and articles on how to pick a money manager. A private client cannot escape these articles. As Emerson aptly said, “A little knowledge is a dangerous thing.” This is our challenge. The growth in awareness has led to a more sophisticated market with a continuing thirst to learn more. Not too long ago, people did not even talk about money. Next month, more than 250 private investors will assemble in New York for [this bank’s] Global Forum. Throughout the year, [another trust bank] hosts family financial forums. [Another large bank] has been doing this for years. One membership group was a sellout in its very first year. When [a no-load mutual fund firm] placed a small advertisement for a retirement planning kit, it broke industry advertising records for the percentage who responded and then bought one of its funds.

What do all these private clients seek? They want to improve their understanding of the

investment issues facing them. The most important topic to [one group of UHNW investors surveyed] is after-tax returns. Warren Koontz presents some astonishing research on the impact of turnover on after tax returns.

THREE MYTHS STILL EMBRACED TODAY

Old but false beliefs about a market segment take time before being widely discredited. The private client market is especially prone to mischaracterization because of its opaque and highly fragmented nature. Three myths continue to be embraced by many firms whose beliefs put them at a disadvantage with private clients.

1. Family-office clients and ultra-high-net-worth (UHNW) investors are more sophisticated than the less wealthy.

Assuming sophistication simply because someone is wealthy derives from the belief that if someone can run a successful business, he or she can be successful at managing his or her wealth. But knowledge and experience—more specifically, sophistication—in investments is more predictive of success. When I first introduced the quadrants of sophistication and control in my 1992 presentation, I argued that these same characteristics were important to assess and were unrelated to level of wealth. Using a series of questions and plotting the answers on quadrants of

sophistication and control, a useful picture emerges. These two critical scores reveal far more than net worth as to how the relationship with a client might unfold. Firms that attempt to segment the market by assets of a client miss an opportunity to scale. Identifying a firm's ideal client using the tools of the quadrants will protect a firm from both unhappy clients and cost overruns in client servicing.⁵

2. The self-made think differently about their wealth than those who inherited their wealth.

While logical, this false belief creates an artificial obstacle to understanding clients' ultimate goals for their wealth. Changing a presentation or client service protocol based on inherited versus self-made wealth will frustrate and confuse most investors. It is better to use the tools of relationship α identified in this brief than to pigeonhole a prospective client.

3. The "Wealth Allocation Framework"⁶ is the same as goals-based allocation.

Many wealth managers mistakenly do not see the important distinction between the "Wealth Allocation Framework" (WAF) and goals-based allocation. While relevant to modest-size assets, goals-based allocation does not include the aspiration inherent in a closely held business that a family intends to keep and finds deeply fulfilling. The family business is not merely an aspirational goal; it is an activity and an

investment allocation within the WAF. For less wealthy clients, there are simpler, more immediate aspirational goals (retiring in X years or funding a child's college education), but this distinction is especially important when a family business represents the majority of a client's wealth. At what level of wealth the WAF should be used is open for debate, but dividing the wealth as Chhabra did in his 2015 groundbreaking work has instant appeal to investors who already have what they might say is "enough" (because of their current asset level). These investors like having a safety bucket, can understand why a market bucket is sensible, and intuitively grasp why the aspirational bucket is often the "why" of their wealth (i.e., what gets them up in the morning). If misinterpreted as identical to goals-based allocation, the WAF does not offer the chance to stimulate a dialogue on the future and, in the process, help create relationship α —unfortunate for both advisor and investor.

HOW PRIVATE CLIENTS VIEW THE INDUSTRY TODAY

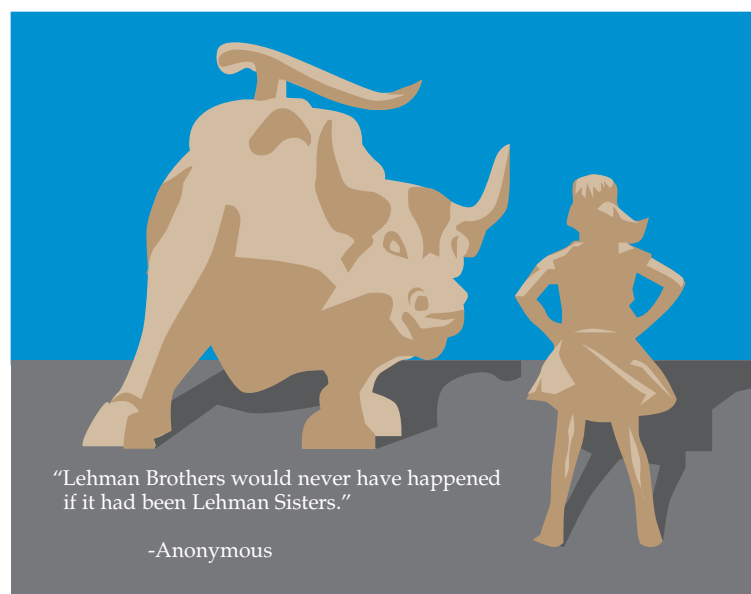
In the aftermath of the 2008–09 financial crisis, more than 10 years ago at the time of this writing, private clients remain skittish and skeptical. For a variety of reasons, including the tax impact of selling funds or individual stocks, no great exodus from the big brand-name firms is evident. A slowdown of new money invested into equity may be hinting at a new investor attitude.⁷ The following are some of the significant "top of mind" issues for clients today:

- Nearly 90% of 4,000 wealthy investors surveyed in a CFA Institute 2016 study noted that the development and management of a goals-based financial plan, rather than the actual advice or investment management, provided the core value of wealth management—a startling finding.⁸
- Even though after-tax returns have finally received attention, with today’s new tax regime and significant estate tax changes (with a five-year expiration!), those who advise private clients in 2019 must be even more attuned to taxes. Having no choice but to realize capital gains in order to terminate one manager and hire another is still a major obstacle to moving accounts.
- Tech-savvy clients demand greater transparency, 24/7 access, and user-friendly formats for all their investments. Legacy systems are frustrating to both client and advisor when data are unavailable at quarter- or month-end—a stark contrast to the highly publicized and advertised capability of fintech.
- The grown children of clients are unhappy with the traditional stock and bond portfolio and see traditional firms as archaic or, worse, “their father’s Oldsmobile.”
- Women prospective clients often are not thrilled to see a photo display of senior management without a single woman in it, so they will move on to interview other firms. The absence of women in senior roles at investment firms is well-known (16% of the CFA Institute US membership is female), yet apparently persistent, a reality that is not so easily remedied.⁹

These last two points were clearly illustrated for me during the 2018 launch of the Chinese edition of my book *Wealth Management Unwrapped, Revised and Expanded*. As I looked out at the 200 HNW investors assembled for the “Evolution of Family” conference in Suzhou, I was struck by the presence of so many young people and more women in the audience than at industry conferences in the United States! Instant and appreciative laughter erupted when I showed my slide of the “Fearless Girl” statue staring down the bull on Wall Street (**Figure 2**). The accompanying caption cited the anonymous quote (in Chinese).

Another anecdote from China concerns the many newly hatched multi-family offices and advisory firms there. These advisors thoughtfully and creatively reinvent themselves over and over again—both in terms of message and implementation—to meet each client’s needs. A few larger firms help educate their clients and prospects by inviting them to attend US universities for a few days to learn about wealth management and securities markets. The intentions of these firms is to help prospective investors be more market savvy and build good will with them.

In another example of how the industry is adapting to savvier investors, one Shanghai-based firm signs a detailed declaration of intention for each client—and means it. Clients become shareholders, reminiscent of the early days of Vanguard when a mutual

FIGURE 2. FEARLESS GIRL STATUE

fund owned by its shareholders was unheard of. With more than 2 million millionaires in China today and more than 7 million in the United States, the opportunity is compelling for new, innovative business approaches, which are being tested in both countries. A new view, increasingly accepted by firms attracting new assets, is that women need to become more visible as leaders in their firms and more involved in servicing their growing number of female clients.

SALES AND SERVICING THAT INCREASE RELATIONSHIP α

"I really don't enjoy marketing to a family office. We never get through our presentation! We get interrupted, and worst of all, sometimes they just end

the meeting very abruptly; it's unprofessional!!"

—A money manager, circa 1990

Such complaints have long been made by asset managers. Many are baffled; they cannot grasp why family-office executives or private investors so often end a presentation before material has been fully explained. Individuals interviewing a firm are not going to "act like professionals" because they are not acting in a professional capacity—this is personal! As one private investor explained, "This may be their livelihood, but it's my life!" One family-office executive I know even insists that firm managers not bring out the presentation book during the first meeting. Instead, he asks the firm, "Why should I hire you over your competitor? What differentiates you?"

Hundreds of private investors have shared with me a common complaint: The firm delivers a “canned”—and usually boring and predictable—presentation. While not wanting an “institutional presentation,” these investors insist they don’t want the “retail” or “dumbed-down” version either. How can this problem be resolved?

Private investors often appreciate professionals who ask them questions like the following:

1. How does your family approach hiring a new money manager? When was the last time you hired a new manager?
2. What is most important for you to hear about first—performance, the team, our process, our approach to taxes/taking gains?
3. How do you perform due diligence on a manager, and what can we cover in this meeting that will be most relevant to you?
4. Would references or consultant reports on our firm be of value to you?
5. What has been your experience with other advisors or money managers?

Private investors often are intrigued by this different approach and enjoy the dialogue. Sometimes these professionals share stories of their work with other families, including how they approached the due diligence process. Investors especially like learning how other families have evaluated the money manager—where the strategy “fits” with the rest of a portfolio. And not surprisingly, these firms end up being hired.

The most successful professionals also engage with both clients and prospective clients in a mutual exploration of how a partnership can work for everyone involved. Discussing issues at the beginning of the process and also throughout the relationship provides solid insurance against precipitous termination. Three tactics for building relationship α at any stage have worked well:

1. Describe a true-to-life dilemma and then ask, “What if I see what’s best for you differently than you do? How should we proceed to make decisions?” Give an example, such as rebalancing in an up market, to liven up the dialogue.
2. Suggest an exercise to explore what ifs—for example, what if next year the markets go down 20%? Examine together the impact on the individual portfolio, and discuss all the possible ramifications using examples of past market downturns and their aftermath.
3. Prepare a short (one- to two-paragraph) case study on a topic of relevance to the client. Send it ahead of your next meeting, and then devote time to discuss it. Include in that case study one or two questions that delve deeper into issues raised, such as marital ownership of assets, rebalancing, family disagreements on investment goals, or tax loss harvesting. I also have seen firms use case studies in firmwide client meetings with great success. Clients compare solutions with one another and learn to see different possibilities. They also gain a greater appreciation for how difficult it

is to offer financial advice when it's not what the client wants to hear.

TODAY'S METRICS—WELL DONE OR OVERDONE?

Measures of success as defined by today's media, such as Barron's rankings, are using the wrong yardstick.¹⁰ These "investor resources" are meant to attract investors to these firms, but they overemphasize assets under management, growth in assets, and the size of accounts. In fact, what they accomplish is record sales of reprints for that publication because firms use the reports heavily in their marketing. Even worse for relationship α , firms evaluate their professionals by how much new business is brought in—every quarter! Rarely is client satisfaction accurately captured,¹¹ much less client retention. If the scorecard is wrong, so is the business strategy, which may doom our industry to extinction. Just as Amazon reinvented the customer experience—and invested for nearly six years before seeing profits—so too must wealth management reinvent the client experience (i.e., relationship α). Amazon reinvented the customer experience using high tech in a number of user-friendly ways, such as the links customers see that tell them, "Customers who bought this item also bought..." followed by a string of related items accessible with one click. Private clients enjoy hearing what other smart and sophisticated clients are doing, and the savvy advisor finds ways to share that information through anecdotes, white papers, and/or client events.

Private investors today seek high tech as well as high touch, but that's expensive for traditional firms. High touch, as defined by many traditional firms, meant huge overhead in client service staff expense, but that is no longer the case. The trend today is to use different marketing strategies and metrics of success, and many professionals and teams of advisors have been breaking away from large organizations because they envision a new and better way to manage wealth. They discarded the old scorecard that measures the wrong metrics. They tossed out the antiquated marketing techniques. These firms might have started out as small boutiques, maybe even unprofitable, but today, several years later, they are profitable, managing \$10 billion or more and staying true to their commitment to put clients' interests first. Like Amazon, many of these startups did not make money—at first. Just as Amazon invested in the customer experience, these de novo firms invested in both high tech and high touch and performed key diagnostics at the beginning of the relationship, sometimes even before the investor became a client. Financial planning by these firms is also more exhaustive, not just a give-away to gain a new client. Prospects recognize and appreciate the deeper conversations. While it is courageous to ask to be paid a fee for such a diagnostic before accepting the new client, the firm is ultimately rewarded for picking this different business model. Both new client and firm will already know each other well and have a mutual understanding, saving time and frustration later on.

ARE THE WRONG PEOPLE TALKING TO PRIVATE CLIENTS?

“I know more than I ever wanted to about the private client. I don’t need to study more about their psyche or attitudes.”

—*A money manager, circa 1996*

In 1996, a money manager’s lack of interest in private clients was, naturally, sensed by those clients, who then removed their assets from the firm. Fast forward 22 years—that same money manager now focuses on manufacturing products and lets other firms distribute the product. Such a decision can represent a moment of truth for firms as they assess their client-facing professionals.

For the past 50+ years, our industry has focused on training advisors using a pedagogy sometimes known as “jug and mug”—that is, teacher speaks, and knowledge pours her jug into the student’s mug (and is hopefully retained). Extensive knowledge can take the advisor only so far toward effective client relationship skills. Old teaching techniques may have worked in the past, imparting a well-defined body of knowledge, but doing so is the equivalent of training airline pilots without a flight simulator. Just knowing the theories of behavioral finance does not translate into relationship α .

Role-playing and case study work are far more likely to change behavior and improve skills than relying solely on a simple academic approach to learning the knowledge. Firms can create powerful training formats that allow professionals to practice these so-called

soft skills. In the process, these firms are likely to recognize that not all client-facing professionals should remain client-facing. Even more awkward, a firm may finally admit that not every senior professional is suited for the initial marketing to a prospect. Likewise, not every charterholder, brand-new or veteran, will be able to learn how to effectively interact with clients. A firm will succeed if it honors both the technical and soft skills and resists the assumption that every professional can be equally adept at both.

MAINTAINING RELATIONSHIP α

Although technical expertise is highly valued, the soft skills are often discounted or, worse, not deemed worthy of academic study—like an unfollowed company or undervalued stock. Unlike physicians, advisors cannot count on some universal understanding as to what is right and what is wrong. “Do no harm” does not translate well for an investor seeking financial security or a secure retirement. A dialogue between advisor and client based on the following five questions helps to forge and increase relationship α :

- Who ultimately decides what is in the client’s best interests?
- What if the advisor and the client do not agree?
- Is the customer always right?
- Who is actually the “boss” in the relationship?
- What might improve this relationship?

To build a partnership, the charterholder client contact professional should pose each of these questions in a timely and appropriate way, adapting to that client's personality and circumstances.

DOES RELATIONSHIP α IMPLY THAT THE CLIENT IS ALWAYS RIGHT?

“Your fees are too high. [This firm] offers index funds for free.”

“I want the highest returns with the lowest risk. . . and lowest fees.”

“I want access to the brains of your firm. I don't want to be pushed off to a low-level client servicer.”

—*UHNW investors*

Not only do investment professionals need to be more honest, but clients also do. They need to assess their own—sometimes unrealistic and unreasonable—expectations and demands. During my 45-year career as a Wall Street salesperson and then entrepreneur, I have had the privilege of learning valuable lessons from 2,500 private investors. I've been shocked by how rarely investors are completely honest with their advisors. I have watched many investors make mistakes, and I have witnessed advisors hurt their businesses unwittingly by their own errors. I've also witnessed

investors learn how to become more confident and make decisions that helped themselves and their families meet important financial and non-financial goals. Countless investors and advisors have confided in me how disappointed—or how thrilled—they were with one another. A profound source of insight has been hearing the stories of UHNW participants who have attended the Wharton Private Wealth Management Program over the past 20 years. The client experience, even if negative, should always be honored, but that does not erase the need for a candid dialogue on expectations.

Happily, private clients can learn how to be better clients and have more satisfying relationships with advisors; however, it takes work on both sides of the table.

CONCLUSION

Today, financial services as a whole still suffers from an erosion of trust. The 2008–09 financial crisis strained relationships; the tension between a client's sense of entitlement and the advisor's need to scale for profitability was like a fragile power line in a snowstorm. The history of our industry is littered with scandals like Bernie Madoff and Wall Street's own focus on short-term profits, destroying good faith in an entire industry.

To write about what I have observed happening in the relationship between client and advisor is a natural result. My goal is to improve the relationships between private investors and their advisors—to illustrate to both how to forge a true partnership. Just as in the doctor/patient relationship,

the investor and advisor must be partners, continually trading important information and listening to one another. They must take complete responsibility for their 50% of the relationship. The guidance in the “10 Principles of Principal”—the 10 action steps outlined for clients in my book *Wealth Management Unwrapped, Revised and Expanded* (2017)—is a to-do list for any individual or family who yearns to find a trusted financial advisor. Advisors can be extremely helpful if they discuss all these topics with prospective clients as they embark on this path toward self-awareness. Not surprisingly, the “10 Principles of Principal” for investors strongly correlate to best practices for advisors, and the Appendix (reprinted here) offers a corollary for each of the 10 principles.

Advisors can immediately apply the “10 Principles of Principal” and their corollaries to their firm’s management, culture, marketing methods, and client service protocols. The result is a firm that is far more confident in the long-term viability of its private client business because professionals learn how to balance the too often conflicting needs of the client and the firm. All clients want to be an important and treasured client. That desire strongly implies high touch—and high cost. Inside an online investor-only community, two different UHNW investors acknowledged these conflicts:

“There’s a desire to fully customize services versus a for-profit firm’s desire to seek

homogeneity in the delivery to maximize profits through scalability.”

“Everyone is entitled to make \$\$\$. The firms are in business to make money, and if you negotiate an extremely low fee, the only way the firm makes money is to minimize their efforts.”¹²

These investors recognize that an advisor is in business and, even more relevant, wants to stay in business and be profitable—not go out of business by trying to satisfy every demand of every private client. Relationship α requires a continual review of the client experience within the context of the firm’s constraints and resources.

This brief argues for a balance between the sometimes competing needs of clients and advisors and illustrates how to overcome the recent toxic loss of faith in our industry. Earning trust is just the beginning, however. Learning how to have a meaningful and more candid dialogue with clients is the next step. As firms grasp the concept of relationship α , our industry—and our clients—will benefit.

My fervent hope is that we can recapture the trust we lost and serve clients exceptionally well while maintaining a profitable business with engaged, talented, and dedicated professionals.

BOOK LIST

Staying abreast of new research in fields other than investing is a daunting task for any investment professional. These 24 books are well worth reading, and I recommend them to interested charterholders and other HNW professionals. I offer a quick review of each. The list is not exhaustive; it includes my favorite books on investor psychology, gender studies, behavioral finance, artificial intelligence (AI), as well as investing for private clients.

Bohnet, Iris. 2016. *What Works: Gender Equality by Design*. Cambridge, MA: Harvard University Press.

This book is a very concrete, data-supported guide on how to design and successfully execute a diversity initiative.

Brunel, Jean. 2015. *Goals-Based Wealth Management: An Integrated and Practical Approach to Changing the Structure of Wealth Advisory Practices*. Hoboken, NJ: John Wiley & Sons.

Upon publication, this book was a truly groundbreaking and thorough explanation of aligning investor goals, as well as behavior, with the investment strategy and process.

Budge, G. Scott. 2008. *The New Financial Advisor: Strategies for Successful Family Wealth Management*. Hoboken, NJ: John Wiley & Sons.

Written by the late G. Scott Budge, an advisor of private clients, this book delves into “soft issues” while clearly describing what works best when advising families with substantial assets.

Chhabra, Ashvin. 2015. *The Aspirational Investor: Taming the Markets to Achieve Your Life’s Goals*. New York: HarperCollins.

A physicist by education, Chhabra’s message may conflict with traditionally accepted approaches to asset allocation, but private clients intuitively and enthusiastically embrace the logic of his “Wealth Allocation Framework.”

Collier, Charles. 2006. *Wealth in Families*, 2nd ed. Cambridge, MA: Harvard University Press.

First published in 1999, Collier’s book was pioneering in its unorthodox approach to advising families. This classic suggests that wealth management for a family is rarely just about the money.

Edwards-Pitt, Coventry. 2014. *Raised Healthy, Wealthy & Wise*.

The first of the series, this book uses anecdotes and testimonials to enlighten the reader.

Edwards-Pitt, Coventry. 2017. *Aged Healthy, Wealthy & Wise: Lessons from Vibrant and Inspiring Elders on How They Designed Their Later Lives*. BP Books.

Using real-life examples, Edwards-Pitt shares original and useful insights into working with aging and elderly clients.

Ellis, Charles D. 2016. *The Index Revolution: Why Investors Should Join It Now*. Hoboken, NJ: John Wiley & Sons.

Ellis, Charles D. 2017. *Winning the Loser’s Game*, 7th ed. New York: McGraw-Hill.

From the author of many books treasured by charterholders, these two books

RELATIONSHIP ALPHA

are actionable and invaluable and make a compelling argument for rules-based index investing.

Gannon, Niall. 2019. *Tailored Wealth Management*. New York: Palgrave Macmillan (part of Springer Nature).

An updated version of Gannon's earlier book, this latest title argues (with supporting historical data) why and how UHNW investors should manage their asset allocation, tax issues, and valuation assessments very differently from the currently accepted industry practices.

Harari, Yuval Noah. 2017. *Homo Deus: A Brief History of Tomorrow*. München: C.H. Beck.

This book is eye-opening and mind expanding, especially for wealth management professionals who are looking for a window into the coming disruption of AI.

Hausner, Lee, and Douglas K. Freeman. 2009. *The Legacy Family: The Definitive Guide to Creating a Successful Multigenerational Family*. New York: Palgrave Macmillan.

A most useful and practical how-to from two veterans whose work with families is widely admired.

Herz Brown, Fredda, and Fran Lotery. 2012. *The Family Wealth Sustainability Toolkit: The Manual*. Hoboken, NJ: John Wiley & Sons.

This book is another very useful and practical guide that includes online assessments that families and their advisors can put to use right away.

Hughes, James E., Jr. 2004. *Family Wealth: Keeping It in the Family*. Princeton, NJ: Bloomberg Press.

This early classic was the first to argue the concept of financial capital as merely the tool of human capital.

Jennings, William W., Stephen M. Horan, and William Reichenstein. 2010. *Private Wealth Management: A Review*. Charlottesville, VA: CFA Institute Research Foundation.

A CFA Institute Research Foundation publication, this book offers portfolio design and investment solutions specific to many different private client situations with ample references for further study.

Lipman, Joanne. 2018. *That's What She Said: What Men Need to Know (and Women Need to Tell Them) about Working Together*. New York: HarperCollins.

Unlike so many others of its genre, Lipman's highly readable book delivers objective and easily adopted methods to balance the gender playing field.

Maister, David H., Charles H. Green, and Robert M. Galford. 2001. *The Trusted Advisor*. New York: Touchstone.

This book offers an early yet still relevant explanation of how trust and advice intersect and why that communication dynamic is not what you may have thought.

Marston, Richard. 2014. *Investing for a Lifetime: Managing Wealth for the "New Normal."* Hoboken, NJ: John Wiley & Sons.

RELATIONSHIP ALPHA

As you would expect from a professor at the Wharton School of the University of Pennsylvania, Marston uses fascinating historical data to address unique challenges facing HNW investors. He also recommends user-friendly and compelling new methods for evaluating performance and assessing outcomes.

Moffitt, Andrea Turner. 2015. *Harness the Power of the Purse: Winning Women Investors*. Los Angeles: Rare Bird Books.

Moffitt presents a well-researched and industry- and university-funded study of how women around the world view their finances as well as excellent suggestions for those who advise them.

Perry, Ellen Miley. 2012. *A Wealth of Possibilities: Navigating Family, Money, and Legacy*. Washington, DC: Egremont Press.

The author's statement that "values are caught not taught" is at the heart of this book's prescriptions.

Rodenbaugh, Marlene, and Gary Gemmill. 2004. *Team Mirroring: Illusions and Realities of Team Dynamics and Development*. Handley Group.

This book offers a most pragmatic and insightful tour of team-building concepts, including how team conflicts arise and how they can be addressed productively through interactive exercises.

Rosplock, Kirby. 2014. *The Complete Family Office Handbook*. Princeton, NJ: Bloomberg Press.

This book offers comprehensive coverage of the many different components and complex inner workings of family offices.

Traister, Rebecca. 2016. *All the Single Ladies*. New York: Simon & Schuster.

An eye-opening primer for anyone interested in dramatic demographic shifts, this book upends antiquated assumptions about women and predicts their huge impact on today's cultural norms and wealth ownership—all within a well-researched historical context.

Williams, Roy O., and Vic Preisser. 2003. *Preparing Heirs: Five Steps to a Successful Transition of Family Wealth and Values*. San Francisco: Robert D. Reed Publishers.

Remaining a classic in its field, this book is read and reread by those who wish to help families and their advisors face intergenerational issues.

Yankelovich, Daniel. 1999. *The Magic of Dialogue: Transforming Conflict into Cooperation*. New York: Touchstone.

The relationship between client and advisor often overlooks the value of dialogue. Yankelovich offers a thorough description of the process that can be readily applied by a firm to its client-servicing protocols.

ENDNOTES

¹André Gide (1869–1951) was a Nobel Prize-winning French author.

²The ICFA (Institute of Chartered Financial Analysts) was founded by the Financial Analysts Federation (FAF) as a credentialing organization in 1961 and incorporated in Charlottesville, VA, in 1962. In 1990, AIMR (Association for Investment Management and Research) was officially founded as the parent company of FAF and ICFA. FAF and ICFA officially merged with and into AIMR on 1 January 2000. The name AIMR was officially changed to CFA Institute in July 2004.

³See Charlotte Beyer, “Understanding Private Client Characteristics,” in *ICFA Continuing Education: Investment Counsel for Private Clients*, edited by John W. Peavy III, 5–10 (Charlottesville, VA: Association for Investment Management and Research, 1993). This book is now out of print, but used copies are available online.

⁴Note that since 1992, the numbers have jumped dramatically. According to New York-based Meridian-IQ’s May 2014 report, there were 31,739 SEC- and state-registered RIA (registered investment advisor) firms. But the North American Securities Administrators Association (NASAA) investment advisor representative (IAR) count is still dwarfed by the roughly 275,000 state-registered broker–dealer reps who are often defined as advisors (<https://riabiz.com/a/2015/11/11/how-many-rias-are-there-no-seriously-how-many>).

In 2016, the Bureau of Labor Statistics found 271,900 personal financial advisors (www.bls.gov/ooh/business-and-financial/personal-financial-advisors.htm). According to the CFP (Certified Financial Planner) board’s June 2018 report, there were 81,089 certified financial planners (www.cfp.net/news-events/research-facts-figures/cfp-professional-demographics).

⁵See page 22 of this brief for a more-detailed description of the exercise.

⁶The “Wealth Allocation Framework” is described in Ashvin Chhabra’s book, *The Aspirational Investor* (2015). Complete reference information is found in the book list at the end of this brief.

⁷Justin Baer and Dawn Lim, “Investors’ New Wagers Are Slowing,” *Wall Street Journal* (11 October 2018). www.wsj.com/articles/a-frenzy-of-new-market-bets-is-fading-1539163801.

⁸CFA Institute, “The Value of Premium Wealth Management for Investors” (2017): 16. www.cfainstitute.org/-/media/documents/support/membership/value-of-premium-wealth-management.ashx.

⁹This statistic is from one of the studies showing and trying to remedy the sluggish progress: “Gender Diversity in Investment Management: New Research for Practitioners on How to Close the Gender Gap,” by Rebecca Fender, Renée Adams, Brad Barber, and Terrance Odean, *Research Foundation Briefs* 2 (5): 3 (CFA Institute Research Foundation, 2016). The concept of “double bias,” as cited by Alpha Architect’s Wes Gray, is uncovered in “Sex Matters: Gender Bias in the Mutual Fund Industry,” by Alexandra Niessen-Ruenzi and Stefan Ruenzi, *Management Science* (forthcoming).

¹⁰Not only does *Barron’s* publish three to four different “Top Advisor” lists every year, but the *Wall Street Journal*, numerous magazines, and online resources also reveal rankings and compete for readership.

¹¹Client satisfaction surveys are notoriously unreliable. First, because so few private clients have the time or inclination to complete the survey, results often show “fat tail” data—very happy clients and very unhappy clients. Focus groups or academic surveys encounter a similar bias. An oft-cited survey of individual investors actually measured the trading behavior of self-directed customers of a discount brokerage firm, hardly the typical wealth management firm’s ideal client! Surveys by the UHNW members of the Institute for Private Investors (IPI) are examples of respondents’ having a vested interest in the results (e.g., Family Performance Tracking®)—another problem. Even those surveys, however, have less than 40% of the membership responding online. Scorpio Research is a notable exception, and data from a recent survey done in partnership with CFA Institute align with my own experience. While private clients are interested in what others are experiencing, not many find \$100 in exchange for participation in a three-hour focus group appealing. Thus, any focus group survey may not capture the relevant psychographic.

¹²These two comments, also found in the Appendix, are repeated here for emphasis because they reveal an opportunity for relationship a with honest conversations between advisor and investor.

APPENDIX

From Wealth Management Unwrapped: Revised and Expanded

A SPECIAL MESSAGE FOR ADVISORS

If you invested the time and read the 14 chapters intended for investors, you are likely an advisor who serves your private clients very well. You are meeting the challenges of rapid changes in our industry and remain steadfast in your dedication to excellence.

Having watched many of you who have met with great success over the years convinced me that each Principle of Principal for the investor naturally prompts action on your part.

These actions build a partnership—one that works as well for you as for the investors you advise.

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1. SELF-AWARENESS IS CRITICAL

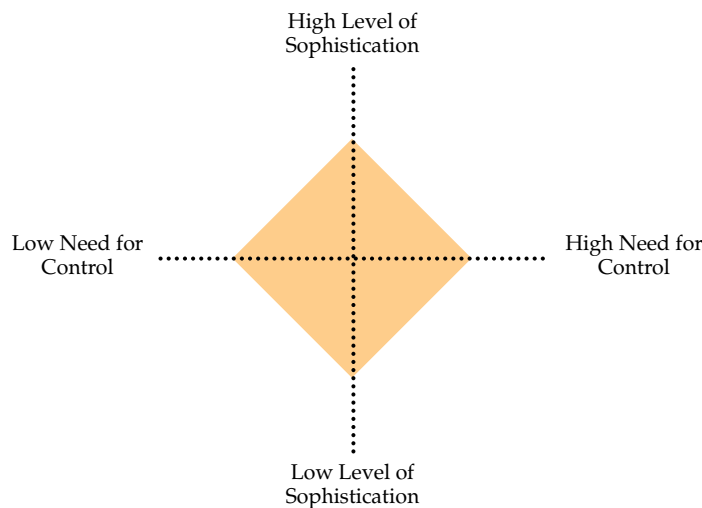
ADVISOR COROLLARY: A firm defines its ideal client and understands which types of investors it serves well and which investors should not become the firm's clients. The firm truly knows what it stands for, how it wants to conduct business, and adheres to a meaningful code of conduct.

To fully engage with your client requires you *both* go on a journey of self-discovery. You might use the Quadrants of Sophistication and Control chart¹ with both your clients and prospective clients. By performing the exercise and placing themselves on this schematic, suddenly they see the potential problems their family might cause you (or any advisor).

You've figured out whom you best serve, turn down inappropriate investors, and save time and aggravation in the process. You probably know where your favorite clients fall. You already enjoy your time together and have a partnership that works.

Your knowing your own core values and what you have in common with your clients is an invisible but powerful insurance policy against clients firing you precipitously. Your conversations can be more forthright; decisions can be more prudent. Your clients will remain loyal to you—even when the going gets rough.

QUADRANTS OF SOPHISTICATION AND CONTROL



2. KNOW YOUR EXPECTATIONS, GOALS, AND IMMEDIATE NEEDS

ADVISOR COROLLARY: Before formally accepting the investor as a client, you help prospective clients discover their investor

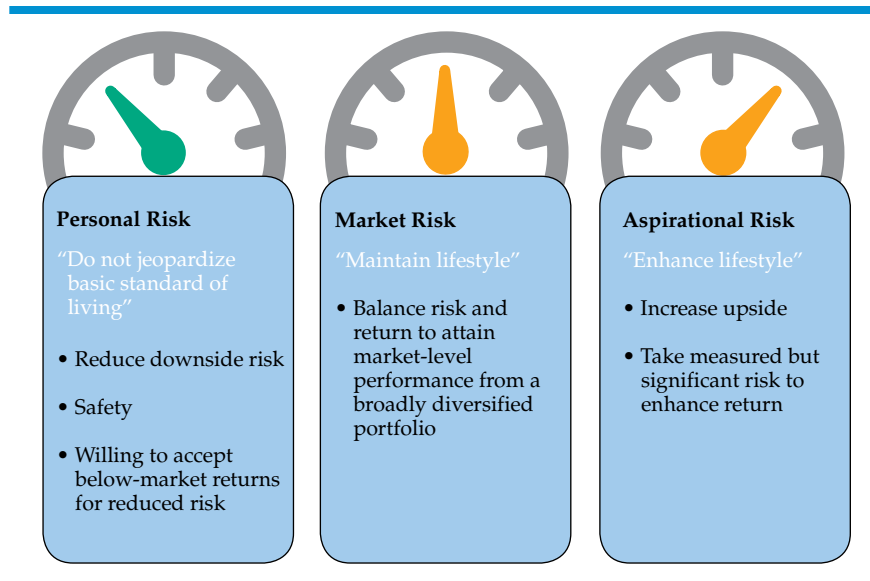
personality, unique needs, and concrete goals. A full client discovery is built into the business development cycle.

In 1988, my boss asked a prospective client, “How much money can we lose before you fire us?” I couldn’t believe what a stupid question he was asking! He was risking our chance to gain a new client! I soon came to realize this was the smartest question to ask any prospective client because it opened up a more candid dialogue on risk. So did Ashvin Chhabra’s groundbreaking work on risk.² He showed that the risk–return perceptions and preferences of individual investors are very different from those of institutional investors. Chhabra readily admits his work was inspired by many entrepreneurs whose wealth had been created by “breaking every

rule of MPT (Modern Portfolio Theory)”³— in other words, concentrating every last dime in the business.

When you employ the Wealth Allocation Framework (WAF), the investor reveals a great deal. Allocating to the different buckets allows you to gain invaluable insight into the investor’s unique views of risk, hoped-for outcomes, and predictions for the future. You also talk about other assets and liabilities, including human capital, and maybe even prepare a family balance sheet.⁴ The insights you gain inform your advice and protect the partnership you’re building.

WEALTH ALLOCATION FRAMEWORK



3. DECIDE WHETHER OR NOT TO HIRE AN ADVISOR

ADVISOR COROLLARY: A firm does not accept any client without first knowing how and by whom decisions are made by the investor/family. Most advisors encounter

clients and prospects whose families are far from the Brady Bunch prototypes. Dealing with financial matters can bring out the best—and worst—in any family.⁵

Early in my career on Wall Street, my boss expressed his disdain for the high-net-worth market. He had just returned from presenting to a family.

I flew all the way out there to meet this family, and everyone was there, joining in the meeting! There was even a woman with a toy poodle on her lap during my entire presentation!

He said he would never again participate in a new business pitch to the ultra-high-net-worth market. “Too frivolous,” he exclaimed,

adding, “Give me a pension investment committee any day!”

What he did not know was wealth management is simply far more complex than institutional business. The “lady with the dog” may have been invited to this meeting in the spirit of involving everyone, even if the final decision would not be made by her. *But you never know!* In working with a family you take the extra time to uncover the family hierarchy and power structures—not because you’ll change them, but because they will be key to partnering with the family.

4. KNOW THE CONFLICTS

ADVISOR COROLLARY: A firm should document all conflicts, including the intangible ones such as how to serve clients well without losing money as a firm.

Sophisticated investors know there are inevitable conflicts, as this investor once observed inside an online forum:

There is a conflict between a family’s desire to fully customize services to its specific family unit versus a for-profit entity’s desire to seek homogeneity in the delivery of services to maximize profitability through scalability. It’s very hard to find a good balance.

But most investors do strive to find that balance and appreciate your candor.

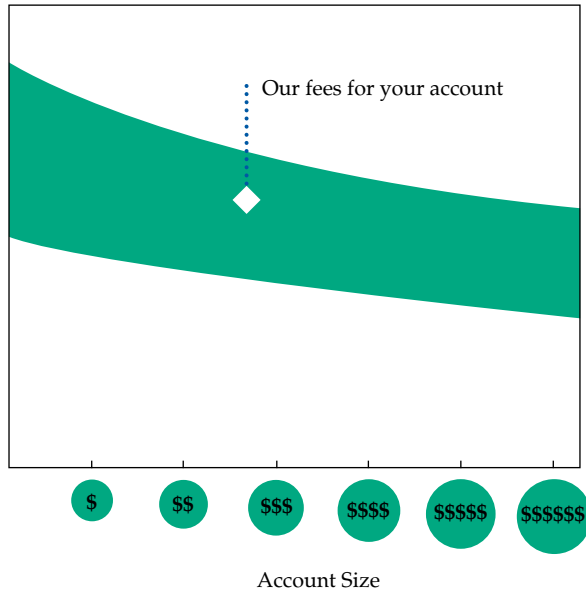
When the discussion on fees comes up, for example, James Grubman introduced a concept in 2007 that intrigued investors. The disclosure you make on this chart⁶ is strong evidence that you want your client to be fully informed and make decisions based on knowing the context—and conflicts. As one investor remarked on the topic of fees,

Everyone is entitled to make \$\$\$. The firms are in business to make money, and if you negotiate an extremely low fee, the only way for the firm to make money on you is to minimize the effort.

Many investors also note a subtle conflict that arises when you are less than candid because you do not wish to risk losing your client. Here is how one investor put it:

RANGE OF FEES IN INDUSTRY

Percentage of Assets per Year



Many advisors are reluctant to tell the truth as they see it to their clients ... advisors are afraid of upsetting their clients, and so don't ask hard questions or urge clients to do something that the clients are not inclined to do. Although this lack of candor may be an understandable human characteristic, it is not especially helpful to us.

On the other hand, investors can easily explain why advisors are well worth it. Here are two such comments:

In a word, my advisor keeps me from making stupid mistakes. I was ready to invest with

Bernie Madoff, and my advisor was adamant that I not move forward because the due diligence was revealing something amiss. This one save more than offset the fees I have paid over the past several years.

My advisor prevented me from making too big a bet. I was prepared to bail, get rid of all my public equity and equity managers in January 2009. My advisor suggested I wait and see. Obviously, I'm glad I did.

When I reflect on the myriad comments I've heard through the years, here's what I believe investors value most about their advisors:

- Keeps me from making dumb decisions
- Has all the time in the world, never rushes me, yet saves me time
- Has amazing resources, and knows when to call on them
- Simplifies my financial life by asking me complex questions
- Stays focused on the big picture for my family
- Is always looking for ways to make things better and simpler
- Is interesting to talk to and listen to

5. DEFINE OUTCOMES

ADVISOR COROLLARY: A firm does not accept a client without an Investment Policy Statement (IPS).

When you make it hard to become a client, an investor’s reaction is at first surprise or even annoyance, but later, a deep respect.

The “getting to know you” meetings become well worth the effort for both of you. You make note of the assumptions you and the investor are making about inflation, goals for the wealth, taxes, securities markets, and fees. The target return and target level of risk are part of the IPS—all this *before* the investor becomes your client.

6. MEASURE OUTCOMES

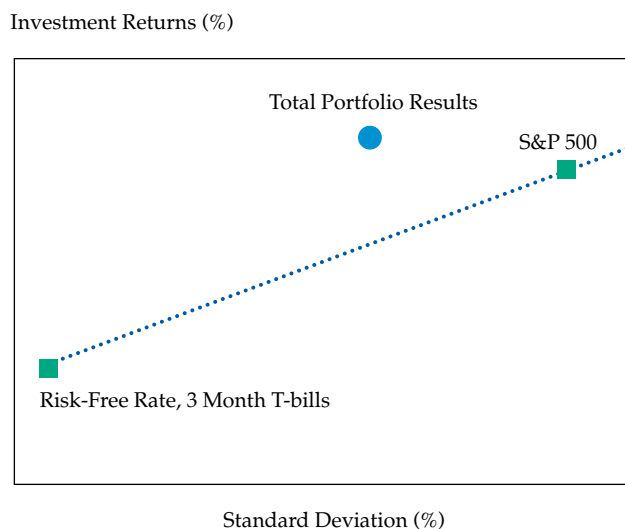
ADVISOR COROLLARY: A firm should produce a simple report card.

Wharton professor Dick Marston⁷ saw the frustration that investors were facing when they tried to evaluate advice from their advisor. Investors continually asked him, “How do I know if my advisor is doing a good job?” In 2004, Marston devised an

intuitive and easily understood approach that he called “alpha star.”⁸

You have already established both a target return and a target risk level as part of the written investment policy. But how do you measure results several years from now? The challenge has always been what benchmark to use for the portfolio *as a whole* since

TOTAL PORTFOLIO PERFORMANCE ON A RISK-ADJUSTED BASIS: A PICTURE IS WORTH A THOUSAND WORDS



each money manager has a different benchmark and risk profile. Alpha star measures the investor's excess return at the risk level of the *investor's* portfolio. This becomes a report card of how well you've done in both asset allocation and manager selection.

Both sophisticated and unsophisticated investors grasp what this measure shows. In every class at Wharton since 1999, some investor has asked Professor Marston, "Why doesn't my advisor show me something like this for my portfolio?"

7. INSIST ON CONSISTENT COMMUNICATIONS

ADVISOR COROLLARY: A firm has a system of reporting to clients and keeps all clients informed on firm policy/investment changes, staff changes/turnover, litigation, client turnover, and new products/services.

Customized client reports can bankrupt the best back office or IT budget. So each year you review exactly what reports are most

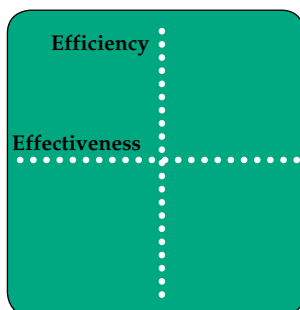
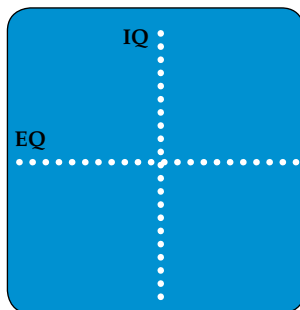
important, are honest about which may not be possible, and agree on timing and format of reports.

An even more daunting task is communicating all this information to your client. Daniel Goleman's *Emotional Intelligence*⁹ transformed how we view business relationships, introducing the term *EQ* into customer service. Professionals with IQ certainly know how to get things done efficiently, while those with EQ know how to communicate effectively, that is, in a way your clients appreciate and grasp—even when it's bad news. While you need to have *both* IQ and EQ, these capabilities are not necessarily embodied in one person. That's why your clients might prefer to have one investment contact and another for all other matters.¹⁰

Here is how one family office executive described his issue with many client reports:

A dump of raw asset and transaction data with no attempt to convey significance of information. You can't see the forest for the trees because some people are responsible to study each tree while families want to know if the forest produces enough bounty to sustain their lives.

EMOTIONAL INTELLIGENCE (EQ) AND IQ: WHO SCORES HIGH ON BOTH?



In fact, investors are often happiest when a one- or two-page executive summary recaps the goals and benchmarks. It's front and center in every report and is more meaningful than pages of data.

Personal and meticulous client service is your way of showing you care about your

client's needs and expectations. You recall key facts and follow up just as you promised you would. Investors will never forget how you made them feel (read: *valued, important*), even though they may forget the charts, the macro forecasts, and asset allocation modeling.¹¹

8. KNOW WHEN TO DO A "RESET"

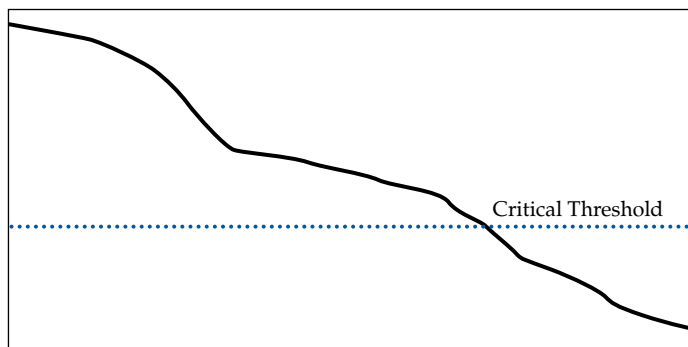
ADVISOR COROLLARY: A firm has clearly defined reset criteria for each client. This reset is not only related to market values but might also include changes to family or decision-making structures. Once triggered, immediate action should be taken, with acknowledgment from both the client and the firm that a reset is in effect.

Sometimes likened to a "stop loss," one investor used a loss of 20 percent as the reset button and incorporated that number into the IPS. This level of specificity offers assurance and comfort to most clients, just as a stop-loss order affords comfort to the owner of a stock.

Because you and your client have agreed upon a target return and a target level of risk over a longer period of time, you have discussed how the road toward that target return will probably not follow a straight line. You can now reexamine those targets and have a conversation recalling why you chose what you chose.

A reset could also occur when the family's decision maker's health deteriorates, or if you identify signs of dementia or Alzheimer's in the person who is your primary contact in the family. The ensuing discussion often sparks a shift in roles and how decisions will be made.

WHEN DO WE RESET? WHILE USUALLY EXPRESSED IN MONETARY TERMS, A RESET CAN ALSO BE TRIGGERED BY A HEALTH ISSUE



9. SUCCESSFUL WEALTH MANAGEMENT IS A JOURNEY, NOT A DESTINATION

ADVISOR COROLLARY: A firm monitors client satisfaction and continues to reexamine how accurately it did its work on principle #1.

Few professionals believe that being a trusted advisor means you have to love your client. And I agree with them. However, most of you eventually address far more than just the money—at which point the relationship becomes more personal. Thus certain principles and skills of loving are highly relevant and in fact essential to building and maintaining your partnership.

More than anything else, we want to love and be loved.

Love is a gift.

Love is not time bound.

Love is good will in action.

Love is a response to need.

Seeing: I do not look over or through you, I see you in your uniqueness.

Hearing: I listen to what you are saying.

Honoring of feelings and ideas:

I recognize your right to think and feel as you do.

Having good will: I will you good

and not evil. I care about you. Responding to need: If you let me know what your needs are, within the limits of my value system, I will not run away. I will be there for you.¹²

Beginning in the early 1990s, industry thought leaders like Jay Hughes described an advisor as a very special individual—one who acts as a trusted confidant and is almost a part of the family.¹³ Clients may call Kathryn McCarthy, Ellen Perry, or Dr. Herz Brown *consultants*,¹⁴ yet that term hardly encompasses the role such trusted advisors serve within a family system. The advice sought from such advisors can be more about family dynamics than investments. There are many other admired and well-respected pioneers¹⁵ in this subset of the wealth management industry. These individuals are the giants upon whose shoulders many advisors stand. Thanks to these teachers, advisors can offer wise and valuable counsel to private investors. You may be one of them, in which case you already know the complexity and deep satisfaction of being a trusted advisor. All those seeking to improve our industry salute you!

10. SUCCESSFUL WEALTH MANAGEMENT SHOULD FREE YOU UP

ADVISOR COROLLARY: A firm is profitable and transacts all business in a way that adheres to the fiduciary standard while ensuring that the firm is viable with well-satisfied clients.

One veteran industry observer distinguished between a profession and a business this way: “Professionalism starts with the conviction that if you never compromise professional standards, never vacillate on matters

APPENDIX

of integrity, and act consistently in clients' long-term interests, the economics will take care of themselves. Great clients are always looking for a few firms that are both superbly skillful and absolute on matters of integrity.”¹⁶

You already have those “great clients” because you have had more authentic conversations about outcomes, performance, and fees. Transparency and candor are still the best and most effective way you earn investors' trust.

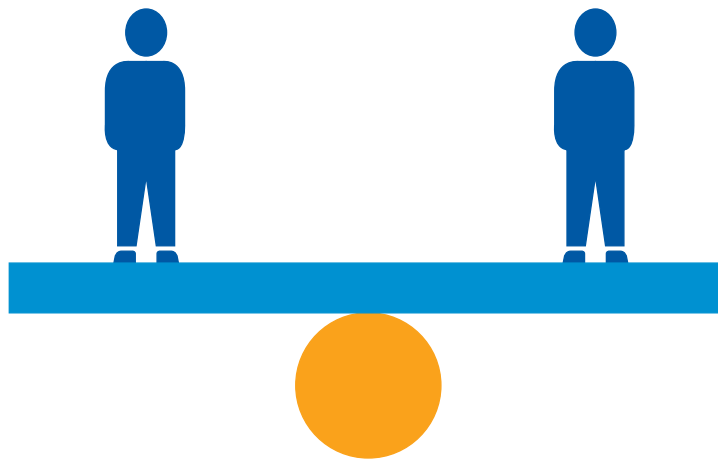
Groups like the CFP Board,¹⁷ Fiduciary Path,¹⁸ the Investments & Wealth Institute,¹⁹ CFA Institute,²⁰ and the AICPA²¹ provide meaningful blueprints for change in our industry. You may already strive to

abide by a code of conduct. You may also show your prospective clients *in writing* exactly how you fulfill your fiduciary duties. These actions build a mutually beneficial partnership.

Whether you are an investor or an advisor, we really are all in this together. A partnership does not have just one winner.

A partnership is akin to two of you standing on a seesaw. You need to trust the person on the opposite end not to hop off or jolt you from your precarious perch. If you both work together, the ride is invigorating and fun. So begin your journey and enjoy the present!

PARTNERSHIP REQUIRES A NEVER-ENDING BALANCING ACT



ENDNOTES

¹The Quadrants of Sophistication and Control were first introduced by the author in a presentation to the AIMR (now CFA Institute) Conference in October 1992 and published in the conference proceedings. Beyer, Charlotte B. (1993), “Understanding Private Client Characteristics,” in

Sherrerd, Katrina E., *Investment Counsel for Private Clients Conference Proceedings* (pp. 5–10). The Quadrants were also discussed in a 2008 article by the author. Beyer, Charlotte B. (2008), “A Retrospective and Prospectus for the Future,” *Journal of Wealth Management*, Vol. 11, No. 3, 9–13.

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²Ashvin Chhabra's Wealth Allocation Framework (also called Objective Portfolio Theory) attempts to bring together Modern Portfolio Theory (MPT) with aspects of behavioral finance in order to create portfolios that are designed to meet individual investors' needs and preferences, as well as to protect individuals from personal, market, and aspirational risk factors. A conclusion of his work is that an investor may choose to accept a slightly lower "average rate of return" in exchange for downside protection and upside potential, essentially implying that, for the individual investor, risk allocation should come first. Chhabra, Ashvin B. (2005), "Beyond Markowitz: A Comprehensive Wealth Allocation Framework for Individual Investors," *Journal of Wealth Management*, Vol. 7, No. 4, 8–34. Reprinted by permission of the creator. All rights reserved. In his 2016 book, *The Aspirational Investor: Taming the Markets to Achieve Your Life's Goals*, Chhabra describes in greater detail how to implement his strategy.

³Chhabra shared that view with a class during the Institute for Private Investors' Private Wealth Management program at Wharton.

⁴Chhabra's inclusion of human capital complements Jay Hughes's and others' work, which urges an advisor to address all five forms of capital: human, social, financial, intellectual, and spiritual. The Family Balance Sheet was an important contribution to the industry, first introduced by Jay Hughes in his 2004 book, *Family Wealth: Keeping It in the Family*.

⁵Thayer Willis aptly describes her own journey and the complex challenges faced by advisors who work with families of wealth in her 2003 book, *Navigating the Dark Side of Wealth*.

⁶This chart was produced by James Grubman, Ph.D., in collaboration with State Street Global Advisors for a webinar. Grubman, James (2007, June 14), "Bridging the Trust Divide: Advisor Best Practices for Communicating Value & Discussing Fees (Webinar)," in *State Street Global Advisors Webinar Series*. Reprinted by permission of the publisher. All rights reserved.

⁷Richard C. Marston, Ph.D., is James R. F. Guy Professor of Finance at Wharton, the director of Wharton's Weiss Center for International Financial Research, and academic director of the Institute for Private Investors' Private Wealth Management program held twice annually at Wharton since 1999. Marston is also the 2014 recipient of IMCA's Matthew R. McArthur Award for outstanding contribution to the profession of investment management consulting.

⁸Marston first introduced the alpha star concept in a 2004 article in the *Journal of Investment Consulting*, and

his latest book, *Investing for a Lifetime* (Wiley, 2014), also discusses other ways to assess the overall portfolio performance. Marston, Richard C. (2004), "Risk-Adjusted Performance of Portfolios," *Journal of Investment Consulting*, Vol. 7, No. 1, pp. 46–54. Adapted and reprinted by permission of the creator. All rights reserved.

⁹Daniel Goleman first introduced the term in his 1995 book based on brain and behavioral research: *Emotional Intelligence*.

¹⁰These IQ and EQ charts were first introduced in a 2009 article written for *CFA Magazine*. Beyer, Charlotte B. (2009, November/December), "Toward a New Science of Private Client Psychology," *CFA Magazine*, Vol. 20, No. 6. Retrieved from www.cfapubs.org/doi/pdf/10.2469/cfm.v20.n6.2.

¹¹Reminiscent of the late Maya Angelou's famous comment, "I've learned that people will forget what you said, people will forget what you did, but people will never forget how you made them feel."

¹²These principles and skills of loving have inspired my work and my life. First described to me by the Reverend Gerald Jud in 1993, these principles state love is an intention, not just a feeling. Most importantly, intention also requires the consistent practice of the skills of loving.

¹³Jay Hughes fully describes the role of such a trusted advisor in *Family Wealth: Keeping It in the Family* (Bloomberg, 2004).

¹⁴Both Ellen Perry's book, *A Wealth of Possibilities: Navigating Family Wealth and Legacy* (Egremont Press, 2012), and Dr. Fredda Herz Brown's *The Family Wealth Sustainability Toolkit: The Manual* co-authored with Fran Lotery (Wiley, 2012) offer a "how to" on creating a values-based foundation for a more intimate and healthier family.

¹⁵A no doubt incomplete list of these "giants" and their books includes: Patricia Angus (*The Trustee Primer*), Charles Collier (*Wealth in Families*), Coventry Edwards-Pitt (*Raised Healthy, Wealthy & Wise*), James Grubman (*Strangers in Paradise*), Lee Hausner (*Children of Paradise and the Legacy Family* co-authored with Douglas Freeman), Charles Lowenhaupt (*Freedom from Wealth* co-authored with Don Trone), Roy Williams (*Preparing Heirs* co-authored with Vic Preisser), and Thayer Willis (*Navigating the Dark Side of Wealth and Beyond Gold*).

¹⁶This quote comes from Charley Ellis's book, *What It Takes: Seven Secrets of Success from the World's Greatest Professional Firms* (Wiley, 2013). He also describes the commercialization of the investment industry and regrettable loss of the sense of a profession in a 2012 article for the CFA Institute *Financial Analysts Journal* entitled "Murder on the Orient Express: The Mystery of Underperformance." Charley Ellis has long been the conscience of the

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investment industry. Jack Bogle, whom I have known and admired since 1993, began speaking to this urgent need to reform how advice is given to investors even earlier than Ellis. Bogle's books addressing this issue include *Common Sense on Mutual Funds* (1999), *Enough* (2008), and *The Little Book of Common Sense Investing* (2007).

¹⁷With roots going back to 1969, The CFP Board (www.cfp.net) is a nonprofit organization acting in the public interest by fostering professional standards in personal financial planning through its setting and enforcement of the education, examination, experience, ethics, and other requirements for CFP® certification, currently held by 140,000 individuals globally.

¹⁸FiduciaryPath (www.fiduciarypath.com) is a private consulting firm engaged to analyze firms' investment fiduciary practices or assess them for certification by the Centre for Fiduciary Excellence (CEFEX).

¹⁹The Investments & Wealth Institute (<https://investmentsandwealth.org/home>) has over 11,000 members worldwide

and can influence our industry. Their Code of Professional Responsibility was first adopted in 1985.

²⁰With over 145,000 members worldwide, CFA Institute (www.cfainstitute.org) can influence our industry. The Code of Ethics (www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx) was a first step toward regaining the trust of the investor. The Statement of Investor Rights (www.cfainstitute.org/learning/future/getinvolved/Pages/statement_of_investor_rights.aspx) was one more.

²¹Founded in 1887, the AICPA (www.AICPA.org) represents the CPA profession nationally regarding rule-making and standard-setting, and serves as an advocate before legislative bodies, public interest groups and other professional organizations. Within the AICPA is the Personal Financial Planning (PFP) membership. The Personal Financial Specialist (PFS™) credential is for CPA professionals specializing in estate, tax, retirement, risk management/insurance and investment planning.

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