

**Brunel
Associates**

Wealth Education & Analysis



Goals-Based Wealth Management In Practice

A new paradigm

CFA Society of Tampa Bay
October 8th, 2013

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Managing Principal

Three Main Points

*Changing
our
thought
process
and putting
that in
practice ...*

- **The generic case**
- **A different process architecture**
- **A different advisory framework**

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The Generic Case

*Structural
as well as
time-
related
needs have
arisen...*

- **The challenges of traditional finance**
- **The reality of biases and preferences**
- **Changes in the environment**

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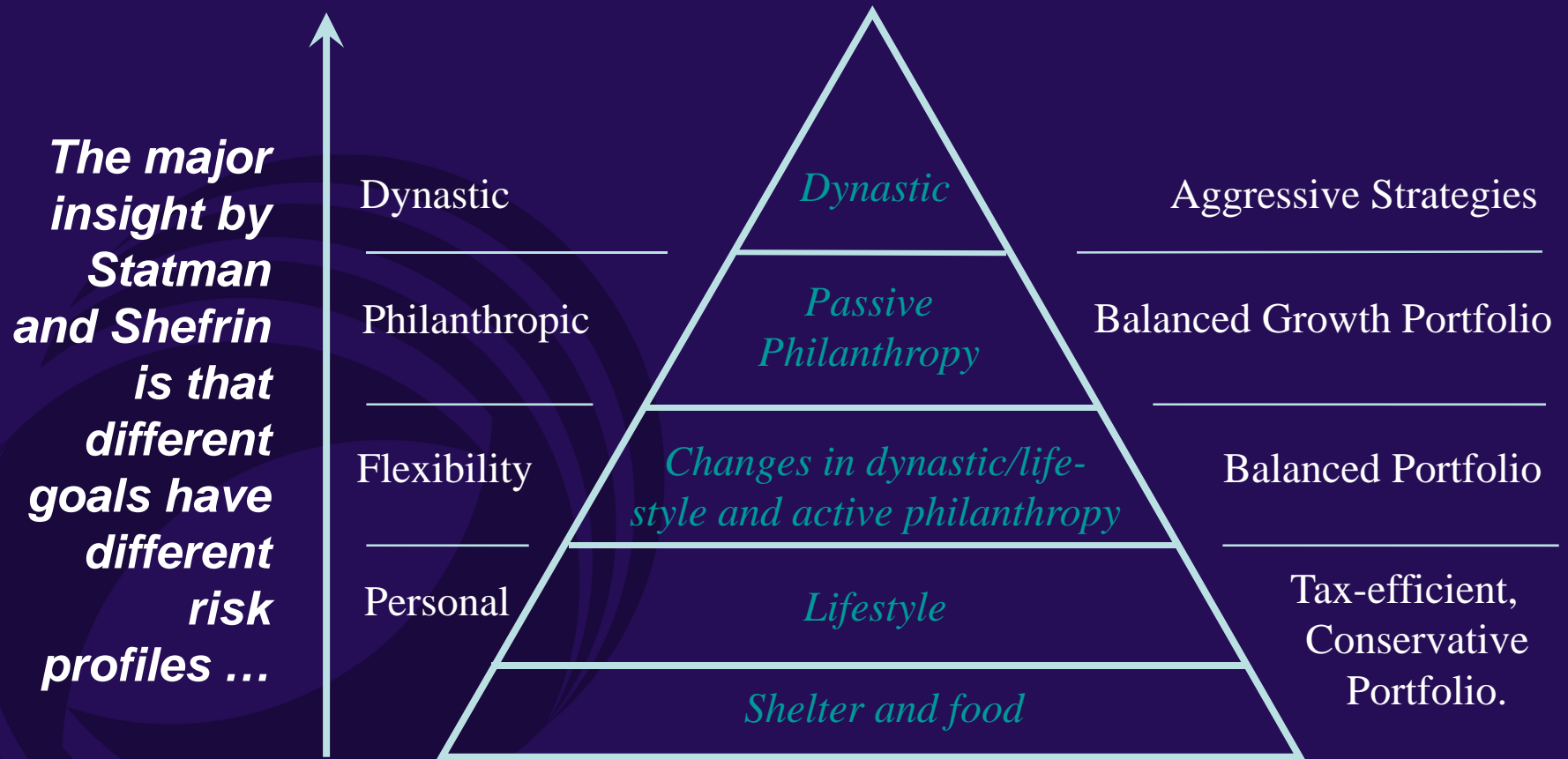
Traditional Finance Challenges

*Traditional
finance is
normative,
while
behavioral
finance is
descriptive*

- Individuals have problems with “liabilities”
- Individuals have multiple goals
- Individuals eschew jargon
- Individuals have biases and preferences

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The Behavioral Portfolio



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Surplus Asset Preferences

*Bringing
real
individual
needs
rather than
theoretical
constructs
into play...*

- **The traditional view:**

Wilcox [2003] discretionary wealth insight
Contingent immunization
Pension surplus management

- **An alternative hypothesis:**

Brunel [2012]: growth vs. capital preservation
Why take the risk of growth
Why eschew the benefits of growth

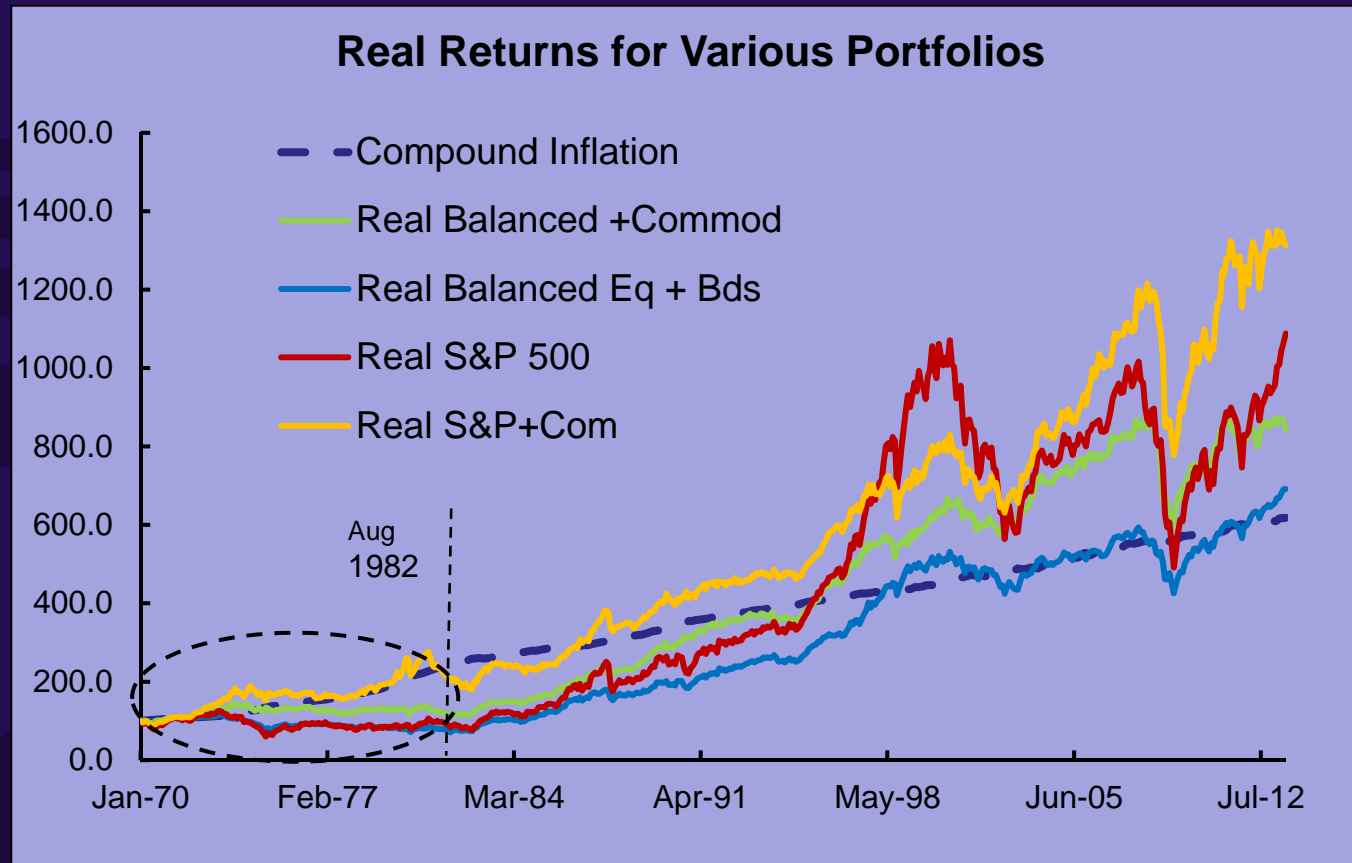
A Different Environment

*Bringing
real
individual
needs
rather than
theoretical
constructs
into play...*

- **Unprecedented economic management:**
Developed country quantitative easing
Massive population in emerging world
- **Potential inflation shock:**
Worrying about cost push inflation
- **Das, Markowitz, Scheid and Statman [2010]:**
Intellectual and academic imprimatur
Shifting the definition of risk

Cost Push Inflation

*Equities
only hedge
demand
pull
inflation...*



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A Different Process Architecture

*We must
start and
finish with
the client
as the only
major
concern...*

- **Integrated wealth planning**
- **A different process**
- **Two different “entry doors”**
- **In short: a different advisory role ...**

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Integrated Wealth Planning

*All
planning
disciplines
contribute
to the
overall
process;
managing
wealth
versus
assets...*

- **Understanding what matters to the family**
- **Identifying all goals:**
Needs, wants, wishes and dreams
- **Identifying all risks:**
Concerns, worries, fears and nightmares
- **Considering all dimensions:**
Personal, dynastic and philanthropic

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Two Entry Points – one Process

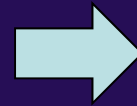
The process can vary, but the end point is the same: a set of goals-based buckets derived to meet each goal...

- **The conceptual start: the behavioral portfolio**
- **An iterative process based on “labels:”**
 - Internal versus external assets
 - Life style versus non-life style assets
 - Growth versus capital preservation bias
 - Real versus nominal nature of goals
- **A discounted cash flow driven process:**
 - Identifying cash flows and time horizons
 - Identifying required success and discount rate

A simple construct

The focus is on structuring a single best suited & optimal portfolio for each client...

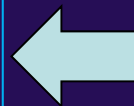
Describe each and every goal



Quantify & prioritize funds needed for each



Manage the whole portfolio



Structure appropriate sub-portfolios

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Three Important Thoughts

This approach places more of a burden on each advisor ...

- **Why choose or avoid growth?**
- **A different conceptual advisory role**
- **Several key caveats**

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Why Choose Growth?

There are justifiable reasons to accept risks and choose growth ...

- Unexpected inflation – what about cost push
- Changes in life style or priorities
- Generation wealth fragmentation
- Mission related investments
- Decision risk minimization: keeping score
- Others ...

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Why Avoid Growth?

There are justifiable reasons to reject risks and choose to preserve capital ...

- **Significant surplus assets**
- **Inability to stay the course in tough times**
- **Avoid unneeded psychological pressures**
- **Learn about capital markets first**
- **Others ...**

A Different Advisory Concept

This approach places more of a burden on each advisor ...

- The advisor is a **TRANSLATOR**
- The family speaks in everyday language
- The advisor understands “financialese”
- The advisor interprets in both directions ...

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Crucial caveats

This approach depends on advisors playing their roles in a firm, humble and complete manner ...

- **Key assumptions must make sense**
- **Avoid determinism**
- **Promote discussions of trade-offs**
- **Promote multiple feedback loops**
- **Mind potential errors of interpretation**
- **Remain humble and flexible**

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A Different Advisory Framework

Areas where tailoring is key, and areas when a central view or process can prevail...

- A consistent firm-wide advisory context
- A client-centered investment policy design
- A consistent firm-wide implementation

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Step 1

Firm-wide Process

**Capital market
Expectations**

+

**Definition of
Client Goals**

+

**Asset/Strategy
Constraints**

=

**Goals-Based
Modules**

Step 1 creates the firm's overall investment management framework, including its philosophy, view of assets and strategies, strategic market conditions ...

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Step 2

Firm-wide Process

Capital market
Expectations

+

Definition of
Client Goals

+

Asset/Strategy
Constraints

=

Goals-Based
Modules

Client Process

Specific
Client Goals

+

Assets Needed
for Each Goal

+

Goals-Based
Modules

=

Specific Client
Allocation

Step 2 matches each client's specific situation and the firm's broad operating principles to arrive at a unique and totally client specific strategic asset allocation...

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Sample Module Allocation

Assumptions										
Total Assets	50,000,000	Input in White Background Cells Only - Darker Background Cells Have Menus								
Tax Status	Taxable									
Client Goals										
		7,500,000				25,000,000				
Minimum Risk Target	Net Expenses	Minimum Risk	Annual Spending	Preserve Purchasing Power		Growth		Personal Real Assets	Surplus Assets	
Target Amount		1,000,000	1,000,000	5,250,000	2,250,000	5,000,000	20,000,000	0		
Confidence Required		95%	95%	70%	70%	70%	70%		Two Choices	
Starting Investment Horizon		0	5							
Ending Time horizon	5	5	15	30	30	30	30		70%	
Surplus Asset Goal			OK	70%	30%	20%	80%		G R PP	
Surplus Asset Module		If F13 = ERROR, Revisit LT Spending Horizon							G R PP	
									OK	
									if K15 = ERROR, Revisit Setting in K12	
Alternative Strategy Eligibility	Yes	Distinct PE Allocation			No					
PE Eligibility	Yes	Traditional Eligibility			Yes					
									if H17 = Yes, Allocate all Assets Except Minimum Risk (in a Lump Sum) to Nominal Growth	
Asset Sufficiency Test		OK	Revisit Assumptions if D17 = ERROR							
Goal Allocation										
Eligible Module Category	All	1 ST L	2 LT L	3 N PP	4 R PP	5 R G	6 G	4,168,269		Real P A
		Minimum Risk	Annual Spending	Purchasing Power Preserv.		Growth		Surplus 1	Surplus 2	
Asset Commitment		5,288,215	8,043,516	5,250,000	2,250,000	5,000,000	20,000,000	2,917,788	1,250,481	0
Target Module		ST L	N PP	N PP	R PP	R G	G	G	R PP	
Expected Return		1	3	3	4	5	6	6	4	
		0.1%	4.2%					OK	OK	
										if K25 = ERROR, Negative Surplus
Terminal Value		0.0		OK	if G28 = ERROR, run solver					

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Sample Dollar Policy Allocation

Strategic Policy Allocation	5,288,215	8,043,516	5,250,000	2,250,000	5,000,000	20,000,000	2,917,788	1,250,481	0	50,000,000
	ALL STRATEGIES									
	1	3	3	4	5	6	6	4		
	ST L	N PP	N PP	R PP	R G	G	G	R PP	PA	Total
<u>Asset Class/Strategy</u>										
Cash	1,374,939	0	0	0	0	0	0	0	0	1,374,939
U.S. Fixed Income Inv. Grade	2,934,957	804,352	525,000	0	0	0	0	0	0	4,264,309
U.S. Fixed Income HY	342,412	40,218	26,250	0	0	239,663	34,964	0	0	683,506
EAFE Fixed Income Hedged	342,412	0	0	0	0	0	0	0	0	342,412
EM Debt	293,496	40,218	26,250	0	0	239,663	34,964	0	0	634,590
RV Hedge	0	120,653	78,750	0	0	0	0	0	0	199,403
Fixed Income and Credit	257	0	0	0	151	447	65	0	0	921
Event Driven	-257	120,653	78,750	105,420	124,849	1,799,553	262,536	58,589	0	2,550,092
Global Macro	0	160,870	105,000	316,259	125,000	1,200,000	175,067	175,767	0	2,257,964
Senior Loans (PE)	0	321,741	210,000	140,784	250,000	520,674	75,961	78,243	0	1,597,404
Mezanine (PE)	0	0	0	0	0	0	0	0	0	0
U.S. Equities	0	723,916	472,500	126,563	593,437	4,050,000	590,852	70,340	0	6,627,608
EAFE Equities	0	563,046	367,500	98,437	461,563	3,150,000	459,552	54,709	0	5,154,806
EM Equities	0	321,741	210,000	56,250	263,750	1,800,000	262,601	31,262	0	2,945,604
Directional Hedge Eq L/S U.S.	0	754,080	492,188	0	0	643,831	93,928	0	0	1,984,026
Directional Hedge Eq L/S Non-U.S.	0	754,080	492,188	0	0	643,831	93,928	0	0	1,984,026
Managed Futures	0	502,720	328,125	140,625	750,000	693,357	101,153	78,155	0	2,594,135
Buyout (PE)	0	351,910	229,692	140,625	372,500	2,009,490	293,163	78,155	0	3,475,536
Venture Capital (PE)	0	50,265	32,808	0	558,750	2,009,490	293,163	0	0	2,944,478
MLPs	0	593,973	387,686	70,326	0	250,000	36,472	39,085	0	1,377,543
REITs	0	890,055	580,939	210,979	0	250,000	36,472	117,255	0	2,085,700
Precious Metals	0	361,958	236,250	281,305	675,000	100,000	14,589	156,341	0	1,825,443
Commodities	0	325,762	212,625	562,610	450,000	0	0	312,681	0	1,863,678
Land (PE)	0	0	0	0	0	0	0	0	0	0
Real Estate (PE)	0	120,653	78,750	0	225,000	100,000	14,589	0	0	538,992
Timber (PE)	0	120,653	78,750	0	150,000	300,000	43,767	0	0	693,170
Overall Total	5,288,215	8,043,516	5,250,000	2,250,182	5,000,000	20,000,000	2,917,788	1,250,582	0	50,000,283

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Sample Policy Allocation

Strategic Policy Allocation	Goals Based Modules									Total
	Expected Return	7.6%	7.6%	7.5%	8.2%	8.3%	8.3%	7.5%	0.0%	
Expected Volatility	5.5%	8.0%	8.0%	7.9%	10.4%	13.0%	13.0%	7.9%	0.0%	9.6%
	ST L	N PP	N PP	R PP	R G	G	G	R PP	PA	Total
	Percent of Capital Allocated									
Asset Class/Strategy	10.6%	16.1%	10.5%	4.5%	10.0%	40.0%	5.8%	2.5%	0.0%	100.0%
Cash	26.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	2.7%
U.S. Fixed Income Inv. Grade	55.5%	10.0%	10.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	8.5%
U.S. Fixed Income HY	6.5%	0.5%	0.5%	0.0%	0.0%	1.2%	1.2%	0.0%	0.0%	1.4%
EAFE Fixed Income Hedged	6.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.7%
EM Debt	5.5%	0.5%	0.5%	0.0%	0.0%	1.2%	1.2%	0.0%	0.0%	1.3%
RV Hedge	0.0%	1.5%	1.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.4%
Fixed Income and Credit	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Event Driven	0.0%	1.5%	1.5%	4.7%	2.5%	9.0%	9.0%	4.7%	0.0%	5.1%
Global Macro	0.0%	2.0%	2.0%	14.1%	2.5%	6.0%	6.0%	14.1%	0.0%	4.5%
Senior Loans (PE)	0.0%	4.0%	4.0%	6.3%	5.0%	2.6%	2.6%	6.3%	0.0%	3.2%
Mezanine (PE)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
U.S. Equities	0.0%	9.0%	9.0%	5.6%	11.9%	20.3%	20.3%	5.6%	0.0%	13.3%
EAFE Equities	0.0%	7.0%	7.0%	4.4%	9.2%	15.7%	15.7%	4.4%	0.0%	10.3%
EM Equities	0.0%	4.0%	4.0%	2.5%	5.3%	9.0%	9.0%	2.5%	0.0%	5.9%
Directional Hedge Eq L/S U.S.	0.0%	9.4%	9.4%	0.0%	0.0%	3.2%	3.2%	0.0%	0.0%	4.0%
Directional Hedge Eq L/S Non-U.S.	0.0%	9.4%	9.4%	0.0%	0.0%	3.2%	3.2%	0.0%	0.0%	4.0%
Managed Futures	0.0%	6.3%	6.3%	6.2%	15.0%	3.5%	3.5%	6.2%	0.0%	5.2%
Buyout (PE)	0.0%	4.4%	4.4%	6.2%	7.4%	10.0%	10.0%	6.2%	0.0%	7.0%
Venture Capital (PE)	0.0%	0.6%	0.6%	0.0%	11.2%	10.0%	10.0%	0.0%	0.0%	5.9%
MLPs	0.0%	7.4%	7.4%	3.1%	0.0%	1.3%	1.3%	3.1%	0.0%	2.8%
REITs	0.0%	11.1%	11.1%	9.4%	0.0%	1.3%	1.3%	9.4%	0.0%	4.2%
Precious Metals	0.0%	4.5%	4.5%	12.5%	13.5%	0.5%	0.5%	12.5%	0.0%	3.7%
Commodities	0.0%	4.1%	4.1%	25.0%	9.0%	0.0%	0.0%	25.0%	0.0%	3.7%
Land (PE)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Real Estate (PE)	0.0%	1.5%	1.5%	0.0%	4.5%	0.5%	0.5%	0.0%	0.0%	1.1%
Timber (PE)	0.0%	1.5%	1.5%	0.0%	3.0%	1.5%	1.5%	0.0%	0.0%	1.4%
Overall Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	0.0%	100.0%

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Step 3

Step 3 combines unique and totally client specific portfolio allocation with the firm's current market views to create a totally unique tilted individual client portfolio ...

Client Process

Specific Client Goals

+

Assets Needed for Each Goal

+

Goals-Based Modules

=

Specific Client Allocation

Firm-wide Process

Specific Client Allocation

+

Tactical View of Opportunities

+

Portfolio Tilting Model

=

Specific Client Tilted Portfolio

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Goals-Based Wealth Management

Firm-wide Process

Capital market
Expectations

Definition of
Client Goals

Asset/Strategy
Constraints

Goals-Based
Modules

Client Process

Specific
Client Goals

+

Assets Needed
for Each Goal

+

Goals-Based
Modules

=

Specific Client
Allocation

Firm-wide Process

Specific Client
Allocation

+

Tactical View of
Opportunities

+

Portfolio
Tilting Model

=

Specific Client
Tilted Portfolio

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In Short, ...

This approach is a potential game-changer in terms of both client satisfaction and profit margins ...

- **A consistent firm-wide framework**
- **A client-centered policy formulation process**
- **A consistent firm-wide individual portfolio implementation**
- **Future developments should focus on:**
 - Tax-efficient periodical portfolio tilting
 - Goals-based module-based reporting

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