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How Wealth Advisors Add Value

Since the 2007-2008 Financial Crisis, client satisfaction with wealth advisors has declined significantly[1] leading many to consider changing existing advisory relationships. Some client dissatisfaction may be due to nothing more than poor communication and/or mismatched expectations, but much of it is undoubtedly well-placed. This paper seeks to address some of the key qualitative and quantitative sources of value added that can be provided by wealth advisors. It also seeks to enumerate several key factors that any family should consider before hiring a new advisor or initiating a change to an existing relationship.

Before we attempt to describe the value of advice, it might be helpful to define what we mean by "wealth advisor." Simply put, a wealth advisor helps structure, implement, monitor and maintain a client's *overall investment portfolio*. This is distinct from a money manager who typically buys and sells securities seeking to generate attractive returns within a narrowly defined mandate (e.g., large cap stocks or high yield bonds). Since we're talking primarily (though not exclusively) about *investment* value-add, we're excluding advisors who are primarily offering non-investment services such as tax, accounting, estate planning, bill paying, etc.

THE MOST IMPORTANT TYPE OF ADVICE FROM YOUR WEALTH ADVISOR

We believe that the single most important type of advice a family can receive from any financial advisor – so important that it outweighs advice of any other kind – is working with the family to design an overall investment strategy *that is right for the family and its specific needs*. Advisory firms that offer one main strategy – "Wouldn't you like to own a portfolio like Yale's? – are doing most families a serious disservice. Yale's portfolio might be terrific for Yale's needs, but it's highly unlikely to meet the needs of many families.

How important is this? It's difficult to be definitive since every family's experience is different, but the anecdotal evidence is bloodcurdling. Failing to design the right portfolio is an extreme example of failing to stick to a long-term investment plan during periods of market stress (Bulls or Bears). Let's go back to the late 1990s.

[1] *US Wealth Management Survey: Trends and Emerging Business Models*, Booz & Company, May 2010.

At that time the stock market was incredibly strong – it was the era of “irrational exuberance” – and tech stocks were even stronger. Families who were being advised by large financial institutions woke up to find themselves in a peculiarly dangerous vortex caused by the intersection of greed and conflicts of interest. Financial institutions were competing with each other to manage every tech IPO that came along, and families were jockeying to get an allocation to those IPOs. The result was not only that families allowed their equity allocations to rise dangerously high – those allocations were also heavily tech-centric.

In other words, these portfolios were far more risky than was appropriate for the families but their advisors weren’t pointing this out. When the Tech Bubble burst, these families were hit very hard. The result was that independent wealth advisors saw their businesses grow rapidly as families fled the big institutions. Unfortunately, the families left with only about 60% of their previous capital.

No doubt some of the family’s lost money because they panicked and sold at the bottom, but if so they were alarmed mainly because their portfolios had become way too risky, far beyond their own tolerance for market fluctuations. Where were their supposed advisors while this was going on? They were too conflicted to speak up.

But many families simply had no choice but to bail out of the markets at the worst time. Let’s look at an example from the institutional world to illustrate how this worked.

In the late 1990s and early 2000s, as the remarkable track record of people like David Swensen at Yale became better known, other, smaller institutions began to clamor for the “Yale Model.” Advisory firms arose to meet this demand, mainly led by refugees from the institutional world.

At first these portfolios did quite well, but trouble erupted in mid-2007 with the Credit Crisis. This was soon followed by the full-blown Financial Crisis and the Great Contraction. The Yale Model is characterized in large part by its very high commitment to illiquid alternative assets, and as the value of traditional equities collapsed the institutions’ allocation to illiquids skyrocketed.

Even among the most elite schools, universities found that they couldn’t support their ongoing operations and/or capital projects without selling liquid or illiquid securities at unfortunate prices. Even Yale and Harvard cancelled or deferred capital projects worth billions and then issued bonds to pay for other activities.[2]

But smaller institutions weren't so fortunate. Their capital projects were necessary simply to keep operating and remain competitive, and they weren't able to sell bonds during the Financial Crisis. They had no choice but to unload good stocks at bad prices just to make ends meet. In other words, the terrific-sounding Yale Model portfolio proved to be anything but terrific for them.

Most families want to grow their capital, of course, but for virtually all families there are other priorities as well. A family might want to better understand its spending across many different entities, generations, and collateral family units. For some families, maintaining an effective philanthropic program is more important than simply adding to the family's bottom line. Increasingly, family members want to apply social or other criteria to their investment activities. Maintaining family cohesion can be far more important than simply getting richer. Whatever a family's goals and objectives, the family's advisor should be there to help.

TRANSITIONING THE PORTFOLIO

The next factor to consider is how the wealth advisor will get you from here to there in terms of your goals. There are a wide range of issues presented by the challenge of transitioning a portfolio from its current posture to the new, hopefully improved strategy. However, the two key issues are:

> Transitioning the portfolio in a way that minimizes costs, especially taxes; and
> Transitioning the portfolio in a way that minimizes market timing risk.

When we say costs, we are mainly referring to taxes. In most portfolios there are appreciated securities and also positions with unrealized losses. Managing those gains and losses in an efficient way is important. In addition, many families own concentrated equity positions, and if those are going to be fully or partly diversified decisions will have to be made about the many strategies available.

[2] Harvard was also forced to sell $1.5 billion from its private equity portfolio at deep discounts. See Stephen C. Sexauer and Laurence B. *Siegel, Alternative Investments in DC Retirement Plans: Opportunities and Concerns*, AJO, June 2014.

Market timing risk refers to the danger of moving out of one asset class and into another just before the abandoned asset class appreciates and the new asset class declines. When the declines are especially severe, a family can lose confidence in its advisor before the relationship has really started. And one important consideration to keep in mind is that if you have just sold your family company for a terrific price, the great likelihood is that the equity markets are near a top.[3]

For example, imagine a family that had sold its business and was sitting in cash and municipal bonds when it engaged a wealth advisor in mid-2007. If the advisor had quickly transitioned the family into an equity-centric portfolio designed for success over the long term, that portfolio would have been clobbered during the 2008 market crisis. It's true that if the family had a very long investment time horizon, the 2008 losses shouldn't have mattered. But *psychologically* it would have been a very difficult eighteen months and the family might have abandoned its new strategy and terminated its new advisor prematurely.

If, instead, the advisor had gradually moved the portfolio from bond-centric to equity-centric, the losses would have been much lower when the market bottomed in early 2009. On the other hand, the portfolio would have missed part of the Bull Market that persisted from early 2009 through 2013. At the end of the day, the family would have been better off from a strict return perspective to make the transition quickly. But since families tend to hate losses more than they love gains, it might make sense to manage these transitions more gradually. Understanding these nuances within the family and transitioning the portfolio accordingly is an important value-add by a wealth advisor.

THE ONGOING ACTIVITIES OF A GOOD WEALTH ADVISOR

The focus of a good wealth advisor, quarter-by-quarter, year-by-year, is to add value to the family's portfolio above and beyond what could be expected from a fully indexed, static position. The following activities are additional ways that a wealth advisor can add value,[4] including:

> Designing an appropriate strategic allocation
> Helping to avoid behaviorally-driven investing mistakes
> Tactically adjusting the portfolio to avoid over-priced market sectors

[3] See "How Not to Invest a Fortune," parts 1-3, available at http://gregorydcurtis.com/how-not-to-invest-a-fortune-part-1-the-set-up/.

[4] A recent white paper by Vanguard suggests that advisors who follow best practices throughout the client relationship can add "about 3%" to the value of the portfolio annually over time. While this number may seem high, roughly half the value results from what Vanguard calls "behavioral coaching," that is, helping the client stick to its long-term strategy through thick and thin. See Kinniry, Jr., Jaconetti, DiJoseph, and Zilbering, *Putting a Value on Your Value: Quantifying Vanguard Advisor's Alpha*, Vanguard Research, March 2014.

- Recommending opportunistic investments
- Selecting from among best-in-class investment managers
- Properly locating investments to optimize the value of trust & estate planning vehicles
- Intelligently managing taxes
- Regularly rebalancing the portfolio
- Maintaining discipline in the face of market turbulence
- Reporting timely and accurate results

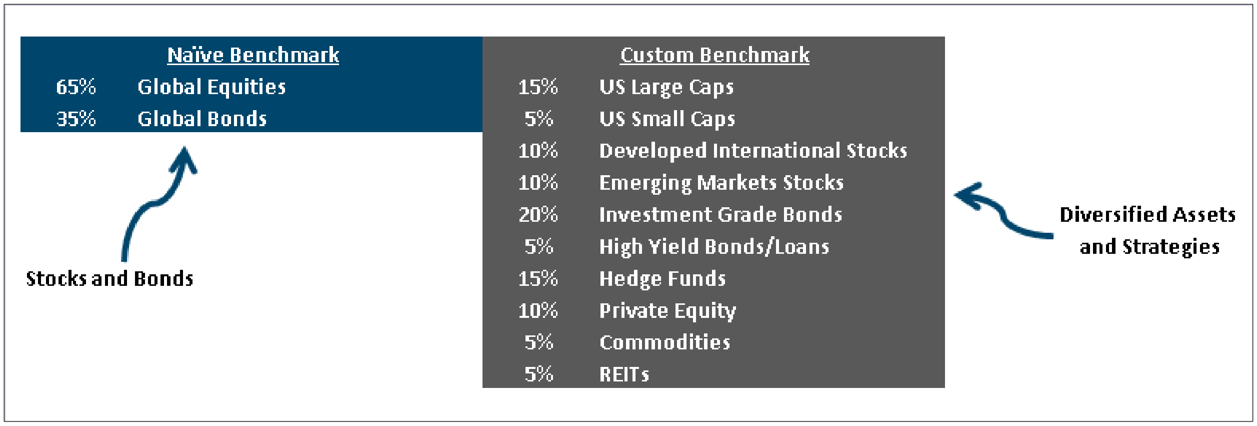
Each of these activities could easily justify an entire white paper. We provide just a quick overview of each here.

Designing an appropriate strategic allocation. We mentioned this earlier: it's essential that the strategy recommended by a wealth advisor be right for your family. In a worst-case situation (as described above), the results can be multi-generationally disastrous. But even in a more normal situation, a family that is pursuing an inappropriate strategy will find itself in a constant state of agitation.

Once you and your advisor have settled on the portfolio long-term asset allocation that is right for you, how do you know whether that strategy is adding value over time? One method to measure the value added of your strategic allocation is to compare the performance of your portfolio's custom benchmark[5] to a simple benchmark comprised of an equally volatile mix of assets: say, one consisting of only one stock index and one bond index. (We refer to these simple portfolios as "naïve" portfolios, no disrespect intended.) The difference in return between your custom benchmark and the "naïve" portfolio isolates the value of strategic allocation decisions.

In the table below we outline a typical example in which the naïve portfolio (the "naïve benchmark") consists of the MSCI All Country World Index and the Barclays Global Aggregate Bond Index. The "custom benchmark" represents the long-term asset class weights selected by the client in consultation with his or her advisor. In this case, the client's portfolio targets exposure to ten asset classes (listed in the table below).

[5] A "custom benchmark" is a group of indices weighted in the same proportions as your strategic asset allocation. In the case of a simple portfolio with 30% allocated to US large cap stocks, 30% allocated to international developed country stocks, 30% allocated to bonds and 10% allocated to cash, the custom benchmark would be 30% S&P 500 Index, 30% EAFE Index, 30% Barclays 1-10 Year Municipal Bond Index, and 10% T-bills.



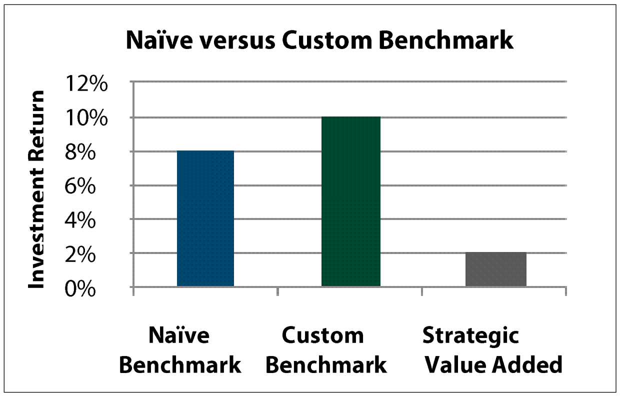
Naïve Benchmark	
65%	Global Equities
35%	Global Bonds

Stocks and Bonds

Custom Benchmark	
15%	US Large Caps
5%	US Small Caps
10%	Developed International Stocks
10%	Emerging Markets Stocks
20%	Investment Grade Bonds
5%	High Yield Bonds/Loans
15%	Hedge Funds
10%	Private Equity
5%	Commodities
5%	REITs

Diversified Assets and Strategies

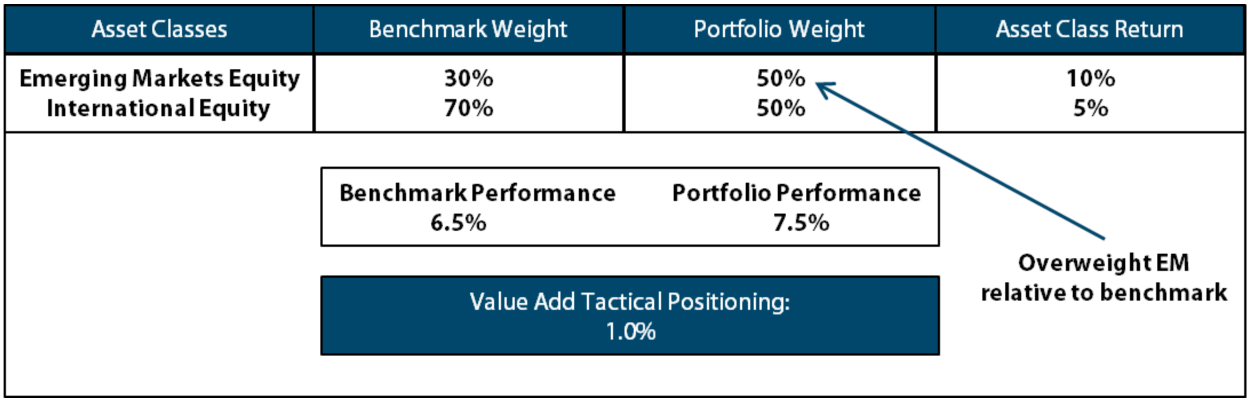
In this example, the naïve benchmark returns 8% and the custom benchmark gains 10% with the same level of volatility which means that strategic asset allocation decisions have added value to the portfolio (2% strategic value added).



Avoiding behaviorally-driven investing mistakes. Even if a long-term strategy is thoughtfully designed, it can be challenging for a family to stick with it during periods of extreme market stress. When equity markets are strong, family preferences for stocks tend to rise, and when equity markets are weak preferences for bonds tend to rise. The trouble here is that the *risk* profile of the portfolio can change dramatically and often in the wrong direction at the wrong time. For example, let's assume that the appropriate strategy for a family is 65/30/5 (stocks/bonds/cash). During a raging Bull Market the family may be tempted to allow allocations to shift to 80/15/5. This is a much riskier portfolio than the one originally designed and when the Bull inevitably turns into a Bear the portfolio will suffer a much greater decline in value than if it had rigorously maintained its original allocation.

And the same thing happens in the other direction. In a Bear Market the family may be tempted to allow its allocation to shift to 50/40/10. This portfolio has nowhere near a large enough allocation to risk assets to meet its long-term objectives. When the Bear turns into a Bull the family won't benefit as it should because its stock exposure is far too low.

Tactically adjusting the portfolio. An advisor can try to keep a family as close to its strategic allocation as possible, simply rebalancing rigorously. But the advisor may also choose to make small (and hopefully well informed) bets deviating from the long-term strategy. For example, as US and other developed markets rose rapidly in 2011-13, emerging markets didn't keep pace. Believing that emerging markets valuations looked attractive relative to developed markets, some advisors began to underweight developed market allocations and overweight emerging markets. Thoughtfully done, such tactical bets can add value over time and it's relatively easy to calculate the value added or subtracted by tactical moves. In the example of developed international versus emerging markets, one would measure the overweight to emerging markets relative to the strategic benchmark weight. Here is a simple example using a two asset portfolio:



Asset Classes	Benchmark Weight	Portfolio Weight	Asset Class Return
Emerging Markets Equity International Equity	30% 70%	50% 50%	10% 5%

Benchmark Performance	Portfolio Performance
6.5%	7.5%

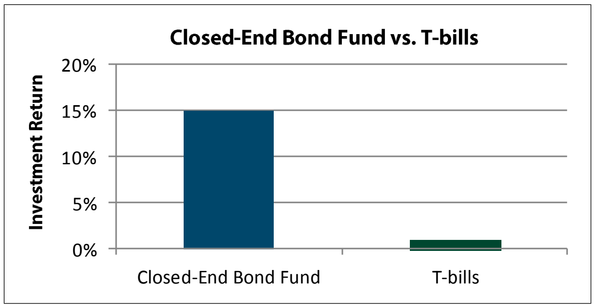
Value Add Tactical Positioning:
1.0%

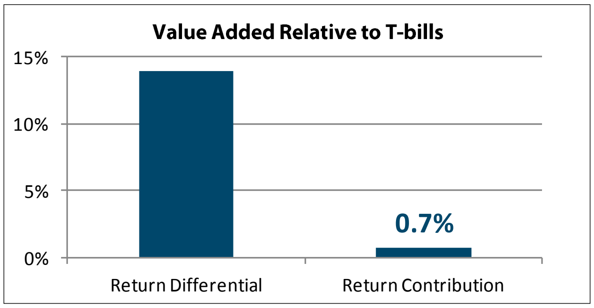
Overweight EM relative to benchmark

In this example, tactically overweighting Emerging Market equities relative to the long-term policy benchmark added 1% of value because Emerging Markets outperformed Developed International equities. If we flipped the performance figures, the tactical emphasis on Emerging Markets equities would have detracted 1% of value from the portfolio.

Recommending opportunistic investments. A thoughtful wealth advisor is constantly sifting through thousands of possible investments around the world and bringing the best and/or most timely of those opportunities to its clients. Very often, these opportunities are created as a result of the irrational behavior of other investors. For example, when the Credit Crisis began in mid-2007, retail investors started to sell closed-end bond funds en masse.[6] Some wealth advisors invested in closed-end bond funds, or even in plain vanilla investment grade corporate bonds, which had also been trashed by fleeing investors.[7]

While the value added or subtracted by an opportunistic investment can easily be calculated, we must be careful to consider its opportunity cost. In the following example an advisor decides to purchase closed-end bond funds, taking the money from cash (for which we use the T-bill rate as a proxy). To examine this trade's absolute performance, we calculate the return differential between the closed-end bond fund and T-bills over the time horizon of the investment, and weight it by the size of the investment measured as a percent of the portfolio. Here is an illustration of that calculation assuming a 5% investment in the closed-end bond fund:





For this particular period of time, we see that the decision to invest in a closed-end bond fund added 70 basis points or 0.7% to the total portfolio return. But does the return on T-bills represent the true opportunity cost of investing in the closed-end bond fund? What other assets could have been sold to acquire the closed-end bond fund?

To capture the full range of potential opportunity costs incurred by electing to invest in closed-end bond funds, the most appropriate benchmark is the balance of the portfolio as represented by the custom benchmark. Here is the comparison to a custom benchmark (again, assuming a 5% investment in the closed-end bond fund):

[6] A closed-end fund is like a mutual fund except that the number of shares offered is static. They are sold like stocks and the price of the fund can be greater or lesser than the net asset value of the fund. When times were good (2005-06) retail investors bid up the price of closed-end bond funds to significant premiums. Then, when the Credit Crisis hit, panicky investors sold in droves, driving the prices to significant discounts. Buying sound closed-end bond funds at a big discount was an almost riskless trade: either investors would calm down and the discounts would return to premiums (as happened) or investors could force the funds to liquidate, gaining them net asset value.

[7] Investor behavior-driven opportunistic investments can sometimes turn around fairly quickly. Both closed-end bond funds and corporate bonds regained their footing within a year, giving timely investors handsome returns relative to the risks of those products.

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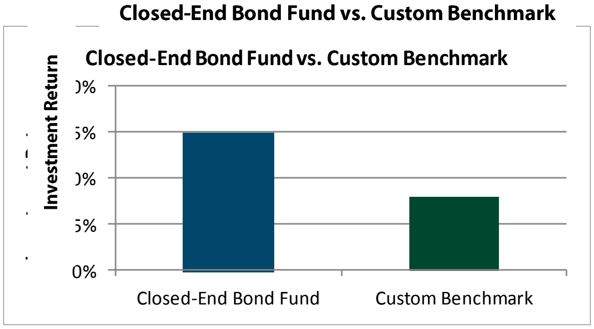
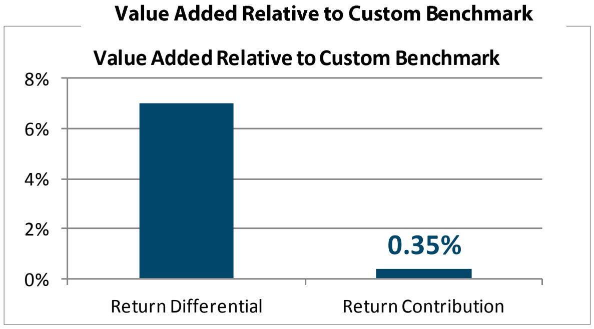
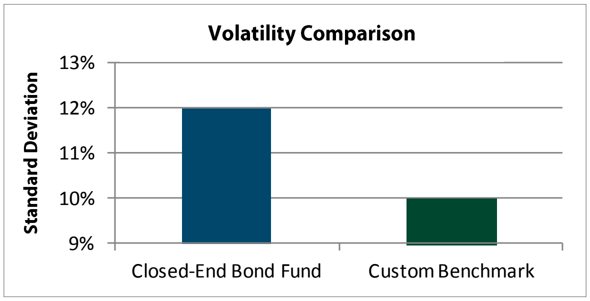
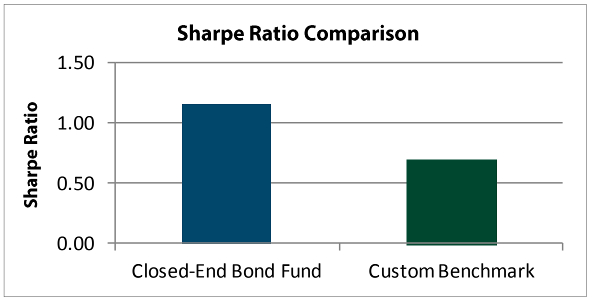




This comparison allows us to more accurately measure that the opportunistic investment in the closed-end bond fund added 35 basis points or 0.35% to the total portfolio return.

The analysis above considers the returns of each scenario but not the relative risks. If we adjust for the respective volatilities of the opportunistic investment and the benchmark, we gain a more comprehensive understanding of the risk-adjusted benefit. As shown below, the closed-end bond fund is a riskier asset than the more diversified custom portfolio, therefore we *should* get more return to compensate us for the risk we are taking. Did we get enough return?





The chart above shows that, while the closed-end bond fund was riskier than the overall portfolio, the investment in the closed-end fund had a higher Sharpe Ratio[8] than the investment in the client's custom portfolio. In other words, the investment in the closed-end bond fund was the superior investment on a risk-adjusted basis as well as on an absolute basis. In conclusion, it is safe to say that the advisor added value to the portfolio. Note the importance of making both the absolute and risk-adjusted calculations.

Selecting investment managers. Full details of our views on how best to identify good active managers are beyond the scope of this paper. We have, however, written extensively on this subject previously.[9]

Two critical sources of value that can be added by advisors are manager selection and manager sizing. To calculate whether a manager chosen by your advisor has outperformed is reasonably simple at the individual manager level but becomes somewhat more complex at the total portfolio level. This is because at the individual manager level, one needs only compare the manager's performance to the most relevant benchmark or peer universe and calculate the return differential. At the portfolio level, however, the value of sizing decisions (e.g., allocating 5% versus 10% to a certain manager) needs to be isolated from the value added by the managers versus their respective benchmarks. Advisors decide not only which manager to use, but also about how much capital to allocate to each manager.

At the *individual manager level*, value added is the return difference between the manager's results and its relevant benchmark.[10] At the *asset class level*, average manager selection value can be measured as the difference in return between an equally-weighted benchmark of managers and the appropriate asset class benchmark. (In other words, we are trying to account for the influence of manager-sizing decisions.)

Advising on asset location. Most large and complex private client portfolios are comprised of a series of interdependent trusts and estate planning vehicles each of which may have different risk tolerances, liquidity requirements, regulatory restrictions and tax treatments. Locating the appropriate managers and strategies within the right entities can be critical to the overall success or failure of the estate planning strategy. A very simple example is how to fund the fixed income portion of various entities. As mentioned above, wealthy families have many different kinds of investors and accounts: highly taxed individual accounts; moderate or low-taxed accounts (grandchildren, for example); accounts which have very long investment time horizons (e.g.,

[8] The Sharpe Ratio is a risk-adjusted measure of return which uses standard deviation to represent risk. Specifically, it is an investment's excess return over the risk-free rate divided by the investment's standard deviation of return.

[9] See Greycourt White Paper No. 2, *How We Work with Money Managers* (May, 2001), Greycourt White Paper No. 32, *Selecting Money Managers* (February 2004), and Greycourt White Paper No. 57, *Actively Passive* (October 2013). See, also, Gregory Curtis, *The Stewardship of Wealth*, Chapter 17, "Working with Money Managers."

[10] Keeping in mind, of course, that indices aren't investable and therefore overstate the return that is actually available to us. Some advisors use actual index funds or ETFs (both of which charge fees) as a more realistic comparison.

GSTs); accounts which have very short time horizons (GRATs for example); different kinds of trusts accounts, some of which will be taxed at the trust level, some at the grantor level, some at the beneficiary level, some not at all (i.e., foundations) and some at multiple levels (i.e., IRAs, GRATs, CLATs, CRUTs and so on). Further, depending on the relationship between interest rates on municipal bonds and interest rates on corporate or government bonds, it may even make sense for families to use "cross-over" bond strategies in which the manager might purchase taxable or non-taxable bonds depending on prevailing market conditions.[11]

Managing taxes. Taxes generally represent the single largest drag on the long term growth of capital. Unfortunately, taxes are very difficult to avoid (legally) and are an inevitable by-product of a successful long-term investment strategy. Competent wealth advisors believe that tax consequences should be understood and optimized, rather than simply minimized. Optimizing taxes means:

> Designing portfolios from the ground up to be tax-efficient.
> Selecting money managers who by default (i.e., low turnover) or design (i.e., explicit tax management) optimize tax realization.
> Harvesting tax losses in one account to offset gains elsewhere.
> Working closely with non-investment advisors like accountants and attorneys to fully understand each client entity's marginal tax rate.

Some aspects of astute tax management can be measured but it is difficult and time consuming to do so. Efforts have been made to standardize the reporting of after-tax returns across the investment industry but such efforts have failed to gain traction because of their complexity and the cost of implementation.

Rebalancing the portfolio. Although studies outlining the impact of rebalancing on returns suggest that strict rebalancing adds value to portfolios, those studies were primarily conducted on non-taxable institutional portfolios. For taxable families, rebalancing often accelerates gain realization, making it uneconomic to

[11] In the Vanguard study cited earlier, the authors calculate that even in simple retail accounts correct asset location decisions can add 75 basis points/year of value. Op. cit., note 1.

rebalance on a frequent basis.[12] For all investors, the importance of portfolio rebalancing lies in its role in controlling risk. As noted earlier, a portfolio that is allowed to drift with the vagaries of the market will tend very quickly to take itself well outside the family's desired risk parameters. Typically, portfolios that are not rebalanced become more risky over time, because on average higher risk assets tend to appreciate faster than lower risk assets.

Avoiding emotional investing. We've already alluded to the importance of sticking to your long-term strategy despite many temptations (fear and greed) encouraging you to deviate from it. Beyond simple rebalancing, advisors can be helpful in dealing with typical, frequently-encountered behavioral issues that can harm your returns.[13] We mention a few examples here.

> *Investing in managers at the right times and for the right reasons*. It is a well-documented phenomenon that investors earn much lower returns (internal rate of return, or IRR) than the managers or funds they have invested in (time-weighted return, or TWR).[14] This sad outcome occurs because investors tend to chase "hot" managers investing in them *after*, rather than *before*, the outperformance has been achieved. On the flip side, investors are often impatient and too quick to terminate existing managers experiencing bouts of short-term underperformance thereby failing to benefit when these managers rebound.

> *Avoiding lousy products*. While it does not show up in the investor's quarterly performance report, the ability of a wealth advisor to steer clients away from inappropriate investments has a significant influence on long-term results. This could be anything from an advisor acting as a buffer for close friends who have the latest "can't miss" ideas to providing an objective opinion about Wall Street's Hot Deal of the Day: say, an 8X leveraged illiquid strategy based on expected fixed income spreads. (And where, incidentally, the management fee was calculated on the leveraged, not actual, dollars invested.)

> *Admitting when we're wrong*. No advisor is right all the time – if that were the case, your fee schedule would look quite different! That said, nothing positive is added to a relationship when an advisor is overly defensive about advice that fails to work out. It harms everything from your trust in the advisor's judgment to the

[12] Note, however, that the Vanguard paper cited earlier suggests that rebalancing can add 35 basis points/year even to a taxable account. Op. cit., note 1.

[13] It's important to recognize that advisors are subject to most of the same behavioral issues as their clients. It is only by working together that our hard-wired inclinations to do the wrong thing can be overcome.

[14] The statistics are cited in Vanguard, op. cit., note 1.

effectiveness of future communications. There is, however, much to be gained from addressing what occurred in a straightforward manner and discussing what the appropriate next steps should be.

Reporting timely and accurate results. Performance reporting is a complex and difficult activity that is fraught with opportunities for errors and misunderstandings. At a minimum, you should expect your advisor's reports to be (a) accurate, (b) timely, and (c) understandable, even to a family member who isn't particularly well-versed in investments. One useful addition to a typical wealth advisor performance report is a "plain English" description of how the portfolio performed for the quarter, the year, and over longer periods, with particular attention to troublesome issues.

A full discussion of benchmarking managers and portfolios is well beyond the scope of this paper, but a few things to keep in mind regarding benchmarks:

> There are no perfect benchmarks – for managers, market segments, or overall portfolios. In particular, short-term deviations from a benchmark (either positive or negative) are rarely meaningful or insightful.

> Typical benchmarks assume daily rebalancing and ignore transaction costs, tax consequences and fees. To state the obvious, this is highly unrepresentative of the real world of portfolio management.

> Private equity and other illiquid assets are typically evaluated on a dollar-weighted basis, as opposed to most other assets that are measured on a time-weighted basis. It is, therefore, very difficult to combine the performance of private equity and other managed assets.

> To be intelligible, there should be several benchmarks for overall family portfolios. For example, a "custom benchmark"[15] allocated exactly according to the family's long-term strategy allows the family to see how much value an advisor has added or subtracted via tactical bets and manager selection. A "naïve benchmark" structured to have the same risk as the family's portfolio, shows a family how it would have performed with a very simple, indexed portfolio.

[15] See note 5, above.

Keep in mind that performance reports only show quantitative results and don't address qualitative value added by the advisor.

A WORD ABOUT FEES

Investment fees, whether paid to wealth advisors, money managers, custodians or others, are extremely important.[16] We believe that fees should be optimized, not minimized – in other words, you want to be sure you are getting value for what you're paying. Consider just some of the many ways it's possible to go wrong on fees:

There will always be advisory firms that can't compete on quality but that can compete on price. If you are in the market for an advisor and one or two of the firms are offering fees significantly lower than the others, this is a red flag. Chances are that the firm offering such a discount is either not able to deliver the services you need or is going to make it up elsewhere (see the following bullet point).

Many firms use advisory fees as loss leaders. For example, if a firm offers wealth advice and also manages money, it might charge very little for the advice and make it up on the asset management side.[17] This is almost universally true of banks, investment banks, brokerage houses, and large asset management firms. Over time, saving a bit on wealth advisory fees and having your money managed in potentially expensive, uncompetitive products is a very poor bargain. Moreover, a firm that charges little for wealth advice is probably never going to be very good at it. In reality, the "wealth advisors" at such firms are likely to be functioning mainly as salespeople for the asset management business.

OTHER IMPORTANT CONSIDERATIONS

For some families – and some family members – the qualitative issues can be more important than quantitative success. Here are some additional "qualitative" value-adds to look for in a wealth advisor:

> ***Expertise.*** Does your advisor come to the table with a point of view that is articulated and well-supported? Or is the advisor consistently wishy-washy: "On the one hand this, on

[16] The Vanguard paper, cited earlier, suggests that paying attention to costs adds about 45 basis points/year to a client's return. Op. cit., note 1.
[17] This is a notorious problem with large financial institutions such as banks, investment banks, large trust companies and even large money management firms.

the other hand that.” Does your advisor have confidence in each recommended manager and a first-hand understanding of each

- manager’s investment strategy? Or does he or she offer several managers and insist that you make the choice?
- ***Communication***. When you talk, is your advisor actually listening? When your advisor talks, is he or she speaking plainly or using industry jargon?
- ***Authenticity***. Is your advisor candid with you? No advisor, no matter how good or how experienced, can know the answer to every question a family might pose. When your advisor doesn’t know the answer, he or she should admit it and go find the answer promptly.
- ***Trust***. Do you have complete trust in your advisor? Most families don’t expect to become close friends with their advisors, but if you feel awkward or uncomfortable with the person on the other side of the table, a change needs to be made.
- ***Partnership***. Note that there are different “levels” to client relationships. A good advisor will help other family advisors – attorneys, accountants, trustees – become even better at their jobs, which will of course ultimately redound to the individual family beneficiary.
- ***Education***. In the course of working with your advisor, do you feel that you are becoming a smarter investor? Most clients will never become professional investors, nor do they wish to do so. But if your advisor is willing to take the time to explain what is happening in the portfolio and in the capital markets, to answer your questions and discuss issues at whatever length and depth you need, over time you will become a better, wiser, more sophisticated steward of your family’s capital.
- ***Objectivity***. We mentioned conflicts of interest earlier in this paper, but we want to end by emphasizing the importance of advisor objectivity. At this writing the SEC itself is trying to decide whether all advisors – including brokers and insurance agents – should be held to the same fiduciary standards as registered investment advisors.[18] Whatever the outcome of that effort (which is being massively opposed by the brokerage and insurance industries), a family that selects a conflicted advisor is playing with fire. Fiduciary standards, which require an advisor to place his clients’ interests first at all times, are both an important bulwark against fraud and also an insurance policy against the slow leakage of family capital that inevitably occurs as a result of everyday financial conflicts

[18] **Full disclosure: One of the co-authors of this paper, Gregory Curtis, serves on the Best Practices Board of the Institute for the Fiduciary Standard and is vigorously advocating the maintenance of a powerful fiduciary standard for all financial advisors.**

of interest.

SUMMARY

Whether a client is looking at quantitative value added or qualitative value added (or both), there are many dimensions to receiving truly valuable advice from an investment advisor. Some issues will resonate more than others with each client, but investors who consider the questions and considerations outlined above will be in a better position to make good decisions regarding their investment advisory relationships. Both before engaging an advisor and throughout the advisory relationship, the client and the advisor should carefully consider whether – and how much – value is being added net of the advisory fee and associated costs.

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