CREATIVE

INTELLIGENCE

Building and Managing Wealth*

By Steve Saenz
FA Business Solutions

* This was originally written as the copy for a public awareness brochure for the Wrap-Fee Association, a predecessor to the Money Management Institute.

FA2020.com

Building & Managing Wealth

Building and managing wealth is the ultimate goal of many investors. In pursuing this goal, rational investors seek to minimize risk while maximizing returns when it comes to investing their hard-earned capital. For a host of reasons, however, this universal goal is becoming increasingly difficult to achieve. Today's volatile markets and rapidly changing economic conditions have made it difficult to determine the best course of action. The perplexing array of choices has made the job of managing one's investment portfolio challenging, at best. Even the "experts" disagree on what investors should be doing with their money.

Fortunately, there is a practical solution. Many investors today are taking advantage of a unique approach to wealth accumulation and management. Rather than trying to manage their own portfolios, these savvy investors are employing the services of professional investment management consultants through the use of *Wrap-Fee Investment Programs*.

This booklet was written for those who might be considering a wrap-fee investment program. Whether you are an individual investor, a trustee or another type of fiduciary, we hope it answers some of your questions and helps you to make a more informed decision.

What Is A Wrap-Fee Investment Program?

A wrap-fee investment program is a customized solution to investing. The term "wrap-fee" actually refers to a *pricing structure* used by a number of financial service providers offering investment management services. These services include investment planning and policy development, manager search and selection, portfolio management, performance measurement and most, or all, transaction charges. Rather than paying commissions for security transactions, investors using wrap-fee investment programs pay a single *advisory fee* for these services. The services are "wrapped" into a comprehensive investment program; thus the term wrap-fee.

One of the distinct advantages of this pricing structure is that the advisory fee is based on the investor's *portfolio value*, rather than on the number of transactions that occur in his/her account. This removes the incentive an investment advisor might have to generate transactions as the number of trades does not affect the compensation he/she receives in any way. This truly puts the investor and his/her advisor on the same side of the table since the advisor can only earn more if his/her clients make money. In a wrap-fee investment program, everyone shares a common objective- to see that the investor's portfolio goes up in value.

How Does This Fee Compare To Other Investment Alternatives?

When compared to other alternatives, wrap-fee investment programs offer significant value to investors. Much of this value lies in the advice and experience of the investment advisor, or consultant, that works closely with the investor to ensure that his/her long-term goals are achieved (please see *The Role of Your Investment Advisor*). In addition, wrap-fee investment programs include a number of services that would be cost-prohibitive, or simply unavailable to many investors. Examples of these services would include a written investment policy, professional investment management and quarterly performance measurement reports that come with most wrap-fee investment programs. When coupled with the advantage of not having to pay commissions for security transactions, these programs begin to look quite cost-effective.

Another significant advantage is that there are *no hidden charges* associated with these programs. Fees are clearly disclosed and are typically charged on a *quarterly* basis. Investors may have their advisory fee deducted from their accounts or may choose to pay them separately. Program fees vary according to portfolio size and the type of portfolio management selected (e.g., equity, balanced or fixed income). Fees may also be partially tax deductible. Investors should consult with their tax advisors regarding their specific situation.

Tailored Portfolio Solution

The technology boom of the 1990's has helped investors in many ways. Unfortunately, the information age has also ushered in a number of less favorable developments. The one that seems to be frustrating investors the most is the shear amount of information, itself. There are too many choices, too many people offering advice and most of them are starting to sound alike. Another common frustration stems from the fact that personalized service is getting hard to find.

A welcomed relief for investors suffering from information overload and generic service is that wrap-fee investment programs are *individually tailored* to meet their specific needs and objectives. This is accomplished through a number of unique features. First, in order to establish a wrap-fee investment program account, investors must complete a *comprehensive questionnaire* that is carefully designed to assess their own unique situation. Money managers are then selected based on each investor's specific criteria. Once the money managers have been selected, portfolios are then managed on an *individualized* basis. In other words, one investor's funds are not co-mingled, or pooled, with those of other investors. This can be a distinct advantage when it comes to tax planning and other portfolio management considerations (see *Wrap-Fee Investment Programs vs. Mutual Funds*).

Professional Investment Management

Another key feature of wrap-fee investment programs is *professional investment management*. Portfolios are usually managed by institutional investment advisors (commonly referred to as money managers) on a *discretionary* basis. This means that investors delegate the *day-to-day* investment decisions to their managers. Professional money managers generally devote all of their time to watching investor portfolios. Given the complexity of the financial markets today, this can be an advantage for investors who do not have the time or expertise to manage their own portfolios. A significant benefit of many wrap-fee investment programs is that they provide investors with *access* to money managers that might not otherwise be available. This is due to the fact that many of the best money managers require minimum investments that are out of the reach of most individual investors.

It is important to note that, while investors assign the *daily* decision-making responsibility to their money managers, they do not in any way relinquish control over their portfolios. In a wrap-fee investment program, investors actually *gain control* of their portfolios by creating an investment plan that must be followed by their money managers. In addition, investors may terminate their relationship with their money managers at any time. There are no specific time commitments or penalties associated with wrap-fee investment programs.

The Role of Your Financial Advisor

In order to appreciate the real value of this unique approach to investing, it is important to understand the role of your financial advisor when using a wrap-fee investment program. In a traditional broker-client relationship, brokers are expected to make investment recommendations to their clients. The clients, in turn, are ultimately responsible for approving or disapproving these recommendations. In a wrap-fee investment program, these responsibilities are delegated to the money managers. Under this arrangement, brokers assume the role of a true *consultant*, assisting their clients in developing long-term investment plans and determining asset allocation strategies for their portfolios. They also provide invaluable research on a wide selection of professional money managers and work closely with their clients to find those managers that are best-suited to handle their portfolios. Once the portfolio managers have been selected, consultants are then responsible for monitoring their clients' portfolios and meeting with them on a regular basis to ensure that their long-term goals and objectives are being met. This ongoing monitoring is an extremely important element of a wrap-fee investment program and one that, ultimately, empowers investors to achieve their goal of building and managing wealth more efficiently.

Keeping You on Track

In the final analysis, the most important aspect of the consultant's role is to *keep you on track*. A common mistake made by individual investors is not staying with their investment plans over the long haul. This is understandable, given the wide variety of investment choices available today and the complexity of the financial markets. Unfortunately, investors often pay a high price for not having or not sticking to an investment plan. As the chart below illustrates, individual investors have not done well when trying to manage their own portfolios. During a recent ten-year period, investor returns lagged market returns by a significant margin.

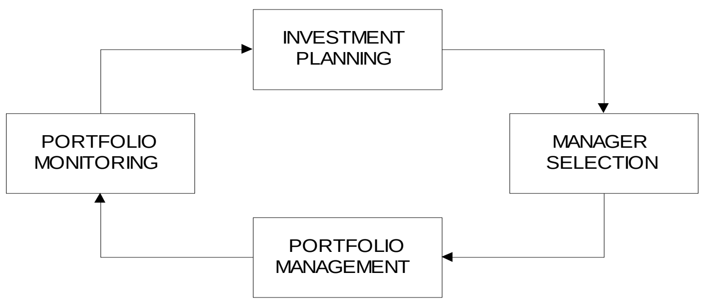
Insert DALBAR chart here

One explanation for this disparity is that individual investors tend to make investment decisions based on emotions. They often buy investments when they see the market rising rapidly or when they hear about an investment, or fund, that has recently achieved superior performance. Alternatively, they are apt to sell their holdings when the market, or their investments, begin to drop in value. "Buying high and selling low" is an investment strategy that is exceedingly counter-productive when it comes to building and managing wealth. By employing the services of a consultant and investing through a wrap-fee investment program, investors are less likely to make these costly mistakes.

Total Portfolio Planning

Wrap-fee investment programs also provide investors with a convenient way to *consolidate* all of their investments. This is because they incorporate a process known as Total Portfolio Planning. As the name suggests, this is an approach used by consultants which takes into account an investor's *entire portfolio* when designing an investment strategy.

TOTAL PORTFOLIO PLANNING PROCESS



The first step in the "process" is *Investment Planning*. This step begins with an assessment of the investor's long-term goals and objectives. This is accomplished by completing an investment questionnaire that has been carefully designed to assess the risk tolerance and return objectives of the investor. Once the goals and objectives have been identified, the consultant would then conduct a comprehensive analysis of the investor's existing portfolio. This involves review all of his/her current holdings, including stocks and bonds, mutual funds, bank accounts and annuities. In addition, the consultant may want to review the investor's retirement plan investments (including 401k plans) as well as non-retirement accounts when formulating an investment strategy. With this information, the consultant would then develop an *investment policy* for the investor which serves as a "road map" for the money managers.

Next, the consultant would conduct a search for one, or more, money managers that will manage the investor's portfolio according to the guidelines established in the investment policy. In conducting their search, consultants will pay close attention to the *risk tolerance* of the investor. They usually present the investor with several choices and assist the investor in making the final selection. *Manager Selection* is a critical part of the process as it often determines whether the investor will, in fact, stay with his/her plan over the long-term.

The next step is *Portfolio Management*. This is where the money managers begin to manage the investor's portfolio. In many cases, the investor's current holdings will be sold in order to make room for the new securities which will be purchased by the managers. Again, it is important to note that the money managers are only responsible for the day-to-day decision making. In most cases, the investor's funds remain in the custody of the financial service firm where he/she is currently doing business.

At this stage in the process, the consultant's attention turns to monitoring the investor's portfolio on an ongoing basis. *Portfolio Monitoring* adds a level of *accountability* that is typically missing from most investment programs. Like a second set of eyes watching the portfolio, the consultant stays focused on the "big picture." His/her responsibilities include keeping the investor informed about all matters relating to the portfolio and to the markets, in general. The consultant is also responsible for keeping an eye on the money managers. This is accomplished though a strict *due diligence* process that monitors every aspect of the money manager's business. This would include adherence to a disciplined investment process and any changes in key personnel that might occur. The ability to monitor money managers with this degree of diligence is a unique feature of wrap-fee investment programs.

In addition to ongoing portfolio monitoring, the consultant is also responsible for meeting with his/her clients on a regular basis to review the portfolio's performance. As part of the service, investors receive a special report that allows them to assess the overall performance of their portfolio and of the individual money managers that have been selected. It is important to note that, while these reports are reviewed on a regular basis, the consultant's job is to ensure that the investor's goals and objectives are met *over the investment time horizon* established by the investor in the investment planning phase of the process.

Wrap-Fee Investment Programs vs. Mutual Funds

A common question asked by investors when considering a wrap-fee investment program is, "How does this approach differ from investing in a mutual fund?" While wrap-fee investment programs and mutual funds are similar in certain respects, there are some significant differences that investors should be aware of.

The main similarity lies in the fact that both represent a type of *professional investment management*. In both cases, investors delegate the day-to-day decision making to a professional money manager. As discussed above, this is a distinct advantage for investors that do not have the time or expertise to manage their own portfolios. Mutual funds also offer investors the ability to *diversify* their portfolios in a very effective way. Investors gain broad diversification by investing in a single fund or in a number of different funds at the same time. This is especially important to individuals who have limited funds to invest.

Another advantage of mutual funds is that they offer *flexibility*. Investors can usually move money from one fund to another whenever they want, although this effectively moves the decision-making responsibility back to the investor.

Another key difference between a mutual fund and a wrap-fee investment program has to do with the way an investor's funds are managed. When an investor places money in a mutual fund, he/she is buying shares of an investment *pool* (legally known as a registered investment company). While the investor owns shares in the fund, he/she does not own the individual stocks or bonds that the fund invests in. In a wrap-fee investment program, the investor actually owns the individual securities that make up his/her portfolio. This is made possible because the investor's funds are separately managed, rather than pooled, as in the case of a mutual fund.

Separate account management offers some distinct advantages. The first has to do with *tax considerations*. When funds are invested in a wrap-fee investment program, the investor establishes a unique cost-basis on each of the underlying securities in his/her portfolio. This may place investors in an advantageous position when it comes to year-end tax planning since they know the status of their realized and unrealized gains at all times.

While mutual funds may be an excellent investment choice for many investors, it is important to keep in mind that they represent just one type of investment *vehicle*. In contrast, wrap-fee investment programs should be viewed as a comprehensive investment *program* which consists of many distinct elements, including professional investment management.

Mutual Fund Wrap Programs

In recent years, another type of wrap-fee investment program has been gaining in popularity among investors. These programs, collectively known as mutual fund wrap programs, represent a *hybrid* between wrap-fee investment programs (with separate account management) and mutual funds. Primarily designed for smaller accounts, mutual fund wrap programs offer investors professional investment management and some, or all, of the services that come with the traditional wrap-fee investment programs (i.e., investment planning, investment selection and portfolio monitoring).

Most mutual fund wrap programs prominently feature a portfolio management strategy known as *asset allocation*. This is an approach that emphasizes asset selection as opposed to security selection. The asset allocation decision focuses on determining the types of investments to include in a portfolio (e.g., stocks vs. bonds) while the security selection decision focuses on which particular stocks or bonds to include.

Another advantage of mutual fund wrap programs is that they usually require a lower minimum investment than traditional wrap-fee investment programs. While these programs do not generally offer the level of personalized attention as traditional wrap-fee investment programs, they are suitable for a broad group of investors.

Establishing A Wrap-Fee Investment Program Account

If you are interested in establishing a wrap-fee investment program account, you should check with your financial advisor. Most investment firms offer the traditional type of program, as well as the mutual fund wrap program. Your financial advisor can help you decide which one is right for you.

The next step is to decide how you will fund your new account. Most programs allow you to fund an account with cash and/or existing securities. If you are planning to use existing securities, you should check with your financial advisor to see if they will sell your current holdings under the wrap-fee pricing structure. This may save you a substantial amount in commissions. In addition, you should examine the tax consequences of selling existing securities before proceeding.

At the end of this booklet is a list of questions you should review with your financial advisor. Whether you are considering a wrap-fee investment program for the first time, or are already using one, these questions should help you in making an informed decision about your particular situation. By taking the time to learn about wrap-fee investment programs and the advantages they offer, you will be well on your way to achieving your goal of building and managing wealth more effectively.

Questions to Review with Your Financial Advisor

Investment Planning

- What are my investment objectives?
- What is my investment time frame?
- What rate of return do I need to achieve from my portfolio?
- What is my risk tolerance?

Asset Allocation

- What is the importance of asset allocation?
- What is the proper asset allocation for my portfolio?

Manager Selection

- Given my personal goals and objectives, which money managers, or funds, are best suited for me?
- Is their investment philosophy consistent with *my* goals and objectives?

Portfolio Review (for established accounts)

- How is my *overall* portfolio doing relative to my investment policy?
- How does the period being measured compare with my investment time frame, as stipulated in my investment policy?
- Are my money managers, or funds, managing my portfolio the way they said they would?*
- Is this consistent with my overall investment goal and time frame?*
- Should I have reason to believe that my long term investment goals will be met by pursuing the current investment strategy?*

* If the answer to any of these questions is "no," changes to the current investment strategy may be in order. If not, you should "stay the course" with your current plan.

About the Author

Steve Saenz is a marketing consultant with more than 30 years of in-the-trenches experience in the financial services industry. His career began in 1983 as an account executive with Merrill Lynch. After five years of production, he moved into training and development as a marketing manager for Merrill Lynch Business Financial Services. In 1991, Steve joined Harris Bretall Sullivan & Smith as the managing director for the Southeastern U.S. In addition to raising $300 million of new SMA assets, Steve helped hundreds of commission-driven advisors make the transition to fee-based investment management consulting. In 1994, Steve founded Paragon Resources and became one of the industry's first practice management coaches. Over the years he has coached and trained thousands of financial advisors in the United States and Canada. He has written about and trained advisors in five key areas – business optimization, client advocacy, practice management, teambuilding and wealth management. His corporate projects include designing the practice management consulting group for a major financial services institution.

You can learn more about Steve and his current projects by visiting his website at FA2020.com