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Wealth Management*

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A ROUNDTABLE DISCUSSION

Los Angeles Business Journal

Wealth Management Roundtable

At the Los Angeles Business Journal, our ears are always to the financial ground, and there are a number of questions that we've been hearing repeatedly from readers navigating the investment, banking and wealth management landscapes. In order to answer those questions, we have once again assembled a financial think-tank's worth of wealth management professionals and invited them to participate in an open forum, Q&A-style roundtable. We're proud to present this discussion featuring some of the most knowledgeable experts in the field of wealth management in Southern California. Several questions were posed to this fund-protecting brain trust and what follows is a transcript of their responses.

ROUNDTABLE PARTICIPANTS:

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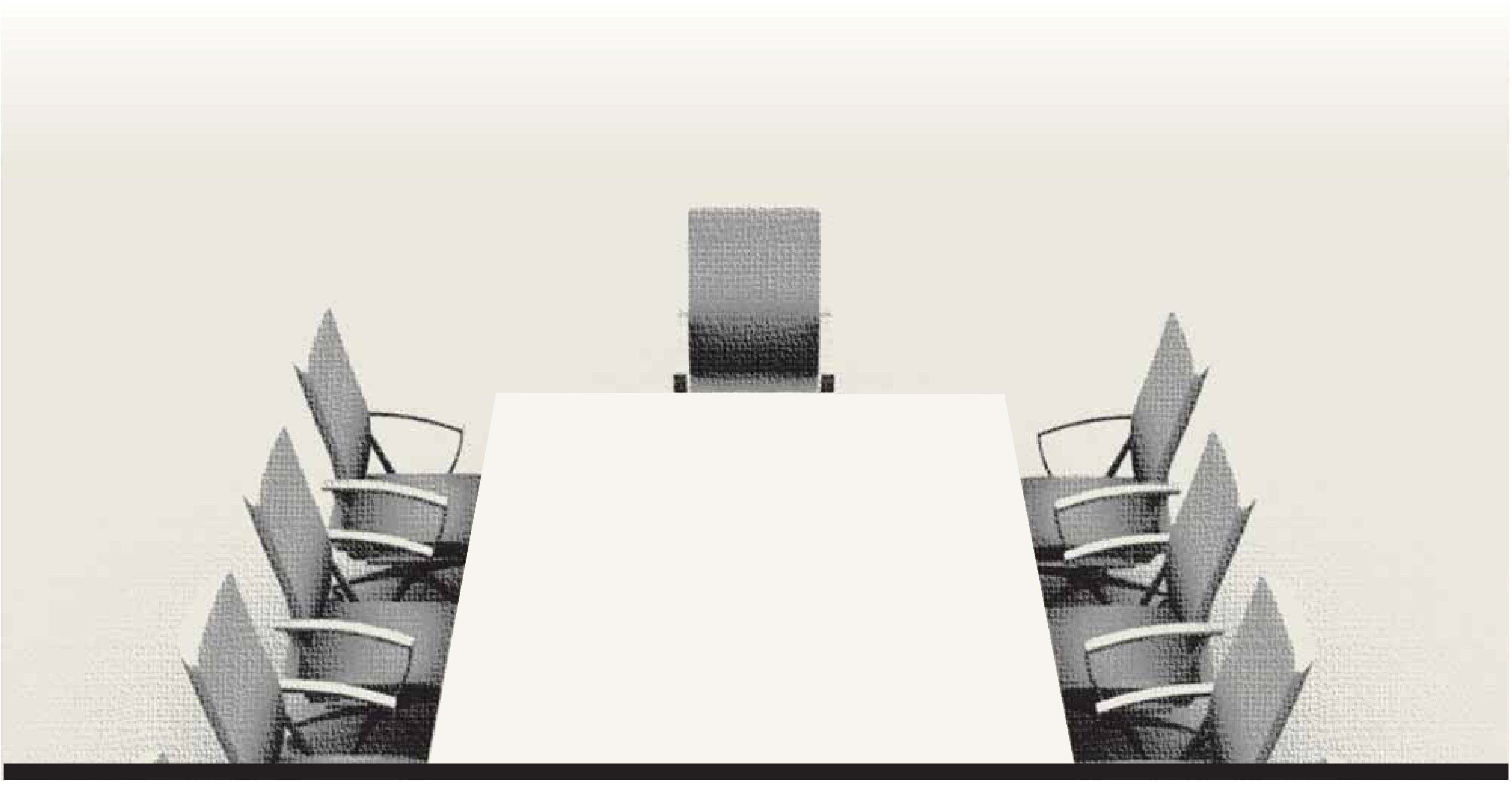

◆ Describe the current investment environment and what you consider to be the best investment approach, in general terms.

SANFORD: In today's environment there are more investment options than ever and, consequently, the number of ways one is able to participate in the market can seem overwhelming. Cable TV and the internet have resulted in a proliferation of investment news and punditry that serves often, ironically, to make decisions more difficult. It is for these reasons that now, more than ever, people need to spend time working with proven professional advisors to determine their long term goals and the safest ways to reach them. Put another way, the best investment approach is based on measured consideration of what a portfolio is meant to do and careful selection of securities based on history and current macro conditions.

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SANFORD

SCHLATTER: Here in the U.S., corporate earnings are up 40% since 2010. Leading economic indicators are showing expansion. Housing markets have risen and home-price appreciation has accelerated. On the monetary policy front, Federal Reserve chairman Ben Bernanke has repeatedly and unequivocally reiterated that the current accommodative monetary policy will continue, despite a surging stock market. While we remain positive about long-term prospects for the stock market we believe there is still plenty of room for the economy to improve. We are cautious in the near term, as we think markets may be vulnerable to profit taking. More important, now that stock prices are much higher, so are the expectations for corporate earnings and investors may be more demanding. Therefore, as always, make sure you have clearly defined your investment goals and have taken the time to determine the proper asset allocation that matches your goals and objectives.

DAHL: The current environment has seen an increased investor appetite for riskier assets, much of which has been fueled by artificially low interest rates and loose monetary policy. These factors supported GDP growth, but elevated unemployment and unsustainable government debt will keep that growth below long-term averages. In our opinion, the best approach in this environment is to purchase large capitalization, dividend-paying equities that derive their revenue globally. We would caution investors against chasing yield. Money flowed into bond funds over the last several years, further depressing yields. This led investors to purchase both longer duration bonds, which face principal risk when rates rise as well as lower credit quality instruments, which have higher default risk. Dividend-paying global equities on the other hand, often have yields nearly double that of the 10 year Treasury bond, offer accounting transparency and exposure to faster growth emerging markets.

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DAHL

◆ How important is developing a comprehensive wealth plan in achieving a client's long term financial objectives?

DOSS: Given all the tax law changes at the Federal, American Tax Payer Relief Act of 2012 (ATRA), and the state, Prop 30, it is absolutely critical to have a comprehensive financial plan. That plan would then be used to build a long-term investment plan. The investment plan should be tailored to each individual's risk preferences & risk needs with a close eye on tax efficiency.

DAHL: A comprehensive wealth management plan that includes estate planning, a customized investment policy statement, and a focus on maximizing after-tax returns is paramount to achieving a client's long-term financial objectives. An investment policy statement in its basic form guides a client's advisor to making proper asset allocation decisions based on the willingness and ability to take risk along with any other specific constraints/requirements. Solid estate planning allows an advisor to maximize after-tax returns by making the proper asset allocation decisions to each designated entity as well as reduce the tax impact of transferring wealth between generations. A few examples would be using the lifetime exemption, utilizing tax-deferred accounts for high income/high turnover strategies and placing tax deferred assets (real estate, mlps, etc.) in accounts that will benefit from a step up in basis.

SCHLATTER: In our view, any family that fails to plan is planning to fail. Not since before 1976 have tax laws been this favorable allowing wealthy families to transfer assets tax-free to younger generations. In fact, with proper planning, wealthy families can transfer virtually an unlimited amount of assets tax free through multiple generations. With respect to investing, at any generation, coordination of a global asset allocation strategy is key to investment success. Often times we see clients with multiple accounts but an overlap of asset classes, which obviously does not create a properly diversified portfolio. Finally, if you do not have a written investment policy statement with clearly defined goals then you're setting yourself up for investment failure.

SANFORD: We believe that developing a comprehensive wealth plan is essential to achieving long-term financial success. No airplane can take off without a flight plan; no ship can sail without a plotted course – and no client can expect a successful

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financial journey without some sort of comprehensive financial, investment and estate plan. We recognize that each client has a unique set of circumstances and goals and through careful analysis and asking the right questions, we are able to establish a plan that addresses both short-term issues such as cash-flow needs, year-end planning and educational funding with long-term objectives such as business succession, retirement planning and philanthropic giving.

◆ What is your general Market Outlook for the remainder of 2013?

DOSS: We have a favorable economic outlook for 2013. We see a continued gradual economic recovery that is uneven across the globe, but is positive at 3.6% Global GDP. The Euro zone will be a laggard with 0% GDP this year. China and the U.S. will grow 7.8% and 2.5% respectively, which is why we are favoring U.S. Large Cap stocks and Emerging Market equities.

ALLEN-ATTAR: In the near term, risk markets like global equities are fully valued and market sentiment is excessively bullish, making them vulnerable to a correction. Morgan Stanley's Spring Outlook Research Report identified two potential triggers for a correction: fiscal tightening in the U.S and/or a return to a crisis point in Europe. However, we view both factors as temporary and would consider such a correction as "a pause that refreshes." Strategically, we prefer equities over debt, bonds or credit. As interest rates are at historic lows, and as long as there is continued liquidity from the Federal Reserve, equities seem cheap relative to credit when adjusted for the risk. Within equities, we strongly prefer quality growth and income. We remain bullish on US housing and have boosted our 2013 house price forecast.

◆ Given your firm's outlook and forecast for the year, what is your best advice for longer-term portfolio asset allocation?

SANFORD: Given record low interest rates, current geopolitical risks, and the bull equity market we're experiencing now, investors should adopt a balanced allocation incorporating a number of asset classes. More specifically, the allocation split between more and less volatile assets should be driven by the long-term goal for the portfolio (e.g. is it expected to be an ongoing source of income or is it meant to fund something in the distant future). With a core bond investment, we would advise against chasing yield by extending duration. Likewise, it's very important to take gains in stocks that have become overpriced to prevent going "round-trip." Finally, when including

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ALLEN-ATTAR

'We almost always recommend strategies that allow wealthy families to gift and/or sell assets tax free to specific types of trusts that allow their assets to transfer through multiple generations while paying zero estate tax and protecting those assets from creditors and divorce.'


SCHLATTER

additional asset classes, we advise our clients to avoid over-diversification by investing in every ETF under the sun. Statistics have shown that selective, strategic use of a limited number of asset classes can provide superior returns.

DAHL: Our forecast for the year assumes that interest rates will remain low and that we will continue to see low, but positive GDP growth driven by increased capital expenditures, increased demand for housing given the low level of inventory, and a rebound in auto sales. Although we see interest rates remaining low in the near future, for longer term portfolios we would be underweight fixed income as yields are anemic and long duration (measure of the sensitivity to interest rates) fixed income will face principal loss when rates rise. The focus of the portfolio should be dividend paying equities that derive their revenue globally, and have a history of growing dividends, not just paying out the highest absolute yield. We would also be buying income producing alternative assets that serve to reduce portfolio volatility, hedge against long-term inflation, and have growing income streams that are often tax advantaged.

ALLEN-ATTAR: Investors need to position their portfolios with the expectation that bonds are going to be volatile, as a result of rising interest rates. For a 30-year period, the developed world has taken on increasing debt. As the world de-leverages, investments that "worked" in the past are unlikely to work going forward and investors need to be leery of seemingly risk-free assets, such as bonds! From 1941 to 1981, bonds experienced a 40-year bear market, as interest rates rose from 1% to 16%. As far as equities are concerned, smart investors have diversified into the Emerging Markets, especially the BRICs (Brazil, Russia, India and China). In his book Breakout Nations, Ruchir Sharma, head of Morgan Stanley Emerging Markets, gives a country by country analysis of the unique forces that will give rise to the next economic success stories, as well as the next flops, in countries other than the BRICs.

◆ What is a nutshell strategy element you almost always recommend to high net-worth individuals in terms, specifically, of making the most of their tax situation?

SCHLATTER: With respect to the transfer tax system i.e. gift taxes and estate taxes, we almost always recommend strategies that allow wealthy families to gift and/or sell assets tax free to specific types of trusts that allow their assets to transfer through multiple generations while paying zero estate tax and protecting those assets from creditors and divorce. In regards to income taxes, we are able to

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WEALTH MANAGEMENT ROUNDTABLE

reduce and in some cases avoid paying Federal and State income taxes on dividends by investing in MLP's and other equities specifically in the energy and health care sectors.

DAHL: At Whittier, the primary element to our strategy is maximizing after-tax investment returns. Executing this strategy requires a holistic, balance sheet approach to wealth management, which involves making efficient asset allocation decisions in each of a client's specific account entities (i.e.: trusts, IRA's, family limited partnerships, etc.). A few examples of this would be utilizing tax-deferred accounts to hold a client's overall allocation to high income and high turnover strategies. The strategy of maximizing after-tax returns also involves seeking out forms of tax-advantaged income and placing those assets in taxable accounts. Assets that currently fit into this tax-advantaged mold include municipal bonds, direct real estate and master limited partnerships.

◆ Has the average investor benefited from the uptick in the market?

SANFORD: Historically, the average investor buys near market peaks and sells-out near market bottoms, missing most of the subsequent market run-up, then buying again after the market has risen. Recently released statistics show that investors put more money into stock mutual funds and ETFs in the months of January and February 2013 than in any month since February 2000. Based on these reports, it would appear that the average investor has once again sold low and are just now starting to buy back into the market. As a private bank with both deposit and wealth management clients, we've unfortunately seen too many deposit clients who have elected to stay in cash and cash equivalents these past four years, missing a bounce of over 130% since the market trough of March 2009.

DOSS: Our average private banking client has benefited from the rise in the equity markets. We stayed focused on the long-term and kept our clients invested in diversified portfolios. Our average balanced portfolio includes fixed income, equities, real assets, and alternative or complementary assets. These highly diversified portfolios have performed quite well over a market cycle.

◆ How do the portfolios of larger more institutional investors differ from those of small investors? Have these investors changed their investing behavior? If so, do you think it is a lasting change?

'Clients are still concerned about transparency of investments. They have been hesitant to invest in hedge funds as a result, so we have had to spend more time educating investors about these types of investments.'

DOSS

'There are too many financial professionals that seek to unnecessarily complicate investment options, rather than trying to help clients by demystifying the various potential choices.'

SANFORD

DAHL: Portfolios of larger institutions vary depending on the entity. For example, pensions have set liabilities and need to hold a larger percentage of fixed income than an endowment. However, two of the major themes taking place in the institutional space are a net reduction of fixed income given the anemic interest rate environment and a shift towards multi-asset portfolios that include a heavier allocation to growth assets including alternatives and equities. We expect this trend to continue as most pensions continue to have high assumed rates of return, which are not attainable with a heavy allocation to fixed income. Many pensions are also underfunded and need to generate higher returns to compensate for these deficits. These combined factors should lead to an increased allocation to growth assets and potentially risk.

ALLEN-ATTAR: Every investor's behavior has been affected by the unprecedented size and scope of the 2008 financial crisis. Morgan Stanley and I personally spend a lot of time on foundations and nonprofit endowments. According to the 2012 study of nonprofits with endowments done by the National Association of Colleges and University Board Organization (NACUBO), endowments have recovered but are exercising caution in investing. The asset allocation of the Study Group's endowments – which ranged from $5 million to over $3 billion – was 16% U.S. stocks, 10% bonds, 17% international stocks, 4% short-term securities and a big 53% to alternative assets such as hedge funds, private equity, commodities, real estate and managed futures. The larger endowments were wary of holding cash and bonds, and made large allocations to stocks and alternatives. The smaller endowments (with assets less than $50 million) have more cash and bonds, smaller allocations to stocks and only 10-25% to alternatives, and have lagged the performance of the larger ones.

◆ Are clients still concerned about transparency of investments, remembering the now five year old Madoff scandal?

DOSS: Clients are still concerned about transparency of investments. They have been hesitant to invest in hedge funds as a result, so we have had to spend more time educating investors about these types of investments. A sound due diligence process is absolutely essential in today's environment, which is what we offer to qualified investors.

SANFORD: Unfortunately, there are too many financial professionals that seek to unnecessarily complicate investment options, rather than trying to help clients

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Salient planning helps the right choices reveal themselves.

John Schlatter, CFP®

Salient Consulting Group's private wealth services helps multi-generational clients with assets between $20 and $500 million. Our services are rooted in developing deep personal relationships to help guide families as they look to grow, enjoy, and protect their wealth. We meet regularly with our clients to consult on best practices to help navigate the challenges of managing family wealth. Our services include:

- Intergenerational Wealth Transfers and Legacy Planning
- Private Wealth Services and Wealth Management
- Philanthropic and Family Foundation Planning

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by demystifying the various potential choices. Too often this added complexity is a way to obscure hidden costs and risks that the client may not be aware of. Our view is that simplicity and transparency are always in the client's best interest, and that if the proposed investment solution is too complex for the client to understand, it is probably inappropriate. If a client is offered a "black box" investment that is too "proprietary" or complicated to fully explain, our advice is to steer clear. Also remember "if it looks too good to be true, it probably is."

ALLEN-ATTAR: According to the NACUBO study, endowments and foundations were disproportionately victimized by the fraudulent investment schemes like Madoff's. In retrospect, it turns out that a little old fashioned in-depth checking would have uncovered the Madoff scandal. The main lesson is that we all need to take due diligence much more seriously. Unfortunately, it takes time, talent and significant resources to evaluate portfolio investment managers and, frankly, most foundations and endowments can't do this on their own. By contrast, consulting groups like Morgan Stanley, with their significant due diligence resources, can do a more in-depth review of the "3 Ps" (Portfolio, People and Process) when they look at hiring portfolio managers! Such firms also have strong conflict of interest policies and procedures that allow a more effective review of the investment products offered to endowment clients.

'In retrospect, it turns out that a little old fashioned in-depth checking would have uncovered the Madoff scandal. The main lesson is that we all need to take due diligence much more seriously.'

ALLEN-ATTAR

◆ What are the issues that are causing your clients and investors to lose sleep at night?

SCHLATTER: Many individual investors still have not forgotten about the financial crisis in 2008 and remain very cautious. This is especially the case for those individual investors that did not maintain their pre-determined asset allocation strategy. For those investors 2008 was a hard lesson to learn. On the flip side, our clients and many other investors have been rewarded for staying the course and maintaining their strategic allocation.

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SCHLATTER

DAHL: Our clients face several issues that are causing them to lose sleep. The first issue being that expansionary monetary policy, a high federal deficit and the debasement of the dollar will lead to high levels of long-term inflation. The second issue was abated for a while, but has resurfaced considering Cyprus and that is the fear of continued pressure on the European banking system and recession. The third issue continues to be the great divide in Washington and the fear that tax rates will continue to increase on the middle class.

SANFORD: The current interest rate environment, with bank deposit rates and coupons for fixed income securities at historic lows, has produced a great deal of concern for investors that are dependent on the income from their portfolios to survive. Unfortunately we have seen many "stretch for yield," which usually involves taking significantly more risk than originally intended. This additional risk can come in many flavors: credit risk, interest rate risk, concentration risk, and structural risk (like double leverage) among others. Rather than adding inappropriate additional risk to the portfolios of individuals that can ill afford a dramatic reduction in their investment principal, we advise taking a diversified "total return" approach with a balanced portfolio that allows for long-term exposure to higher returning equities that will help maintain the purchasing power of a portfolio.

DOSS: Investors continue to be frustrated by the political dysfunction that exists in both Washington, D.C. and in Europe. They understand that we need to put the United States budget back on a more solid fiscal path, and are concerned that we have not made enough progress yet. Our focus remains, however, on helping clients achieve their long-term financial objectives. This means that they cannot hold excessive cash for the long run.

◆ Are illiquidity of certain investments like private equity and venture capital, or leverage for hedge funds a source of concern for clients or are those asset classes back in high demand as a source of Alpha, with potential of outperformance?

ALLEN-ATTAR: Traditionally, institutional clients like endowments looked to the large university endowments as models of investing "best practices." The so-called Yale and Harvard endowment models were diverse, and had a very high percentage of the portfolio invested in illiquid assets like private equity, physical commodities and other real assets. During the financial crisis, the illiquidity of these assets became a problem for many. As their liquid investment portfolios lost value, they were forced to sell their illiquid assets at a discount. According to the NACUBO study, other sources of concern were the high fees and lack of transparency of investment managers and the leverage used by hedge fund managers. Despite this experience, the potential of superior investment returns, keeps investors in these assets—witness the high (53%) allocation to alternatives found in the NACUBO study. Increasingly, smaller investors can access alternatives with smaller minimum investments, and they're becoming popular there, too.

◆ What are some emerging trends that will impact the way that clients invest?

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SCHLATTER: Although Cyprus finally reached a bailout deal with the European union, European equity markets remained unsettled. The immediate, worst-case scenario - Cyprus being forced out of the Euro zone - was avoided. Nevertheless, investors remain worried that the deal, which requires private bank depositors to incur losses, may become the new template for future bailouts. Additionally, European bank stocks were hit hard and the euro tumbled to multi-month lows against the dollar. Conversely, U.S. Equity markets were little affected by Cyprus; rather investors focused on continuing improvements in domestic macroeconomic conditions especially those centered around housing. In addition, the U.S. political environment has also improved somewhat. Despite their profound ideological differences, Republicans and Democrats reached an agreement on government funding for the remainder of the 2013 fiscal year, well ahead of the deadline.

ALLEN-ATTAR: We see a growing number of clients ask for portfolio "outperformance," not only against financial benchmarks but also in relation to social and environmental impact benchmarks. Foundation and endowment clients today are more conscious of aligning the core values of their organizations and families with the investment of their money.

DOSS: One of our Investment themes for this year and last year is the Global Consumer as an Engine of Growth. The rise of the consumer in the emerging markets will have a dramatic affect on global demand. For example, middle class emerging consumers should rise from 2 billion people to 3 billion people in just ten years. We want to make sure our portfolios are positioned to take advantage of these global growth opportunities.

◆ **What should a client be asking his or her advisor in 2013?**

SANFORD: A client should be asking: Is my portfolio positioned to benefit from the market movements we expect to see in 2013? More specifically, does the portfolio have the right asset allocation, the right balance between risk assets and low-risk assets, the right exposure to the faster-growing economies of the world, the right level of diversification, and the right balance between my need for income and my need for long-term portfolio growth. It is important to understand that the correct answers to these questions may be different for each client. That is why finding an advisor that can "customize" a portfolio after listening intently to a client should be the most important objective for 2013.

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DOSS

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DAHL

◆ **How are income tax changes and trends affecting your estate planning and tax management strategies?**

SCHLATTER: Due to increasing income tax rates for wealthy families here in California and considering that many individual investors still have not forgotten the financial crisis in 2008, investing for tax advantaged income and growth has become of paramount importance. There are MLP's and other equities in energy and health care that are extremely profitable and have been tremendous performers this past decade and are off to a fantastic start this decade. The investments pay dividends that are not currently taxed or are only partially taxed - until the stock is sold at which point a capital gain tax is due. However, if the stock is held until one spouse passes away and the assets are community property, then the surviving spouse will receive a stepped up basis and can sell the stock at that point and avoid all taxes. For younger individuals, the capital gain tax can be eliminated simply by transferring and then selling the stock(s) inside a charitable remainder trust (CRUT) which can also provide tax advantaged income over the investor's lifetime.

DAHL: Washington has become increasingly polarized, and estate planning and tax management strategies have gained in importance. Increasing tax rates have increased our use of tax-advantaged income producing assets such as mlps and real estate that offer strong long-term hedges against inflation. Capital gains rates for high net worth clients increased and could increase more in the future. Therefore, for clients holding low basis, non-core positions in taxable accounts, we have increased the realization of long-term capital gains and continue to place high turnover strategies in tax-deferred accounts. Also, although the estate tax exemption is "permanent," we have been encouraging clients to accelerate their use of the exemption.

◆ **What are the major changes for the business of wealth management in the last five years and what key strategy changes do you anticipate in the next five?**

SCHLATTER: In the past five years, the amount of assets a wealthy family can transfer by way of gift to younger generations has increased from 2m to 10.5m and by way of sale from 20m to 100m. As a result, younger generations will need to do additional planning over the next 5 years to maintain proper stewardship of family assets. As a result, affluent families will look to their advisors to be well educated in the transfer tax system and well versed in asset protection. In addition, it will be important for wealthy families to work with advi-

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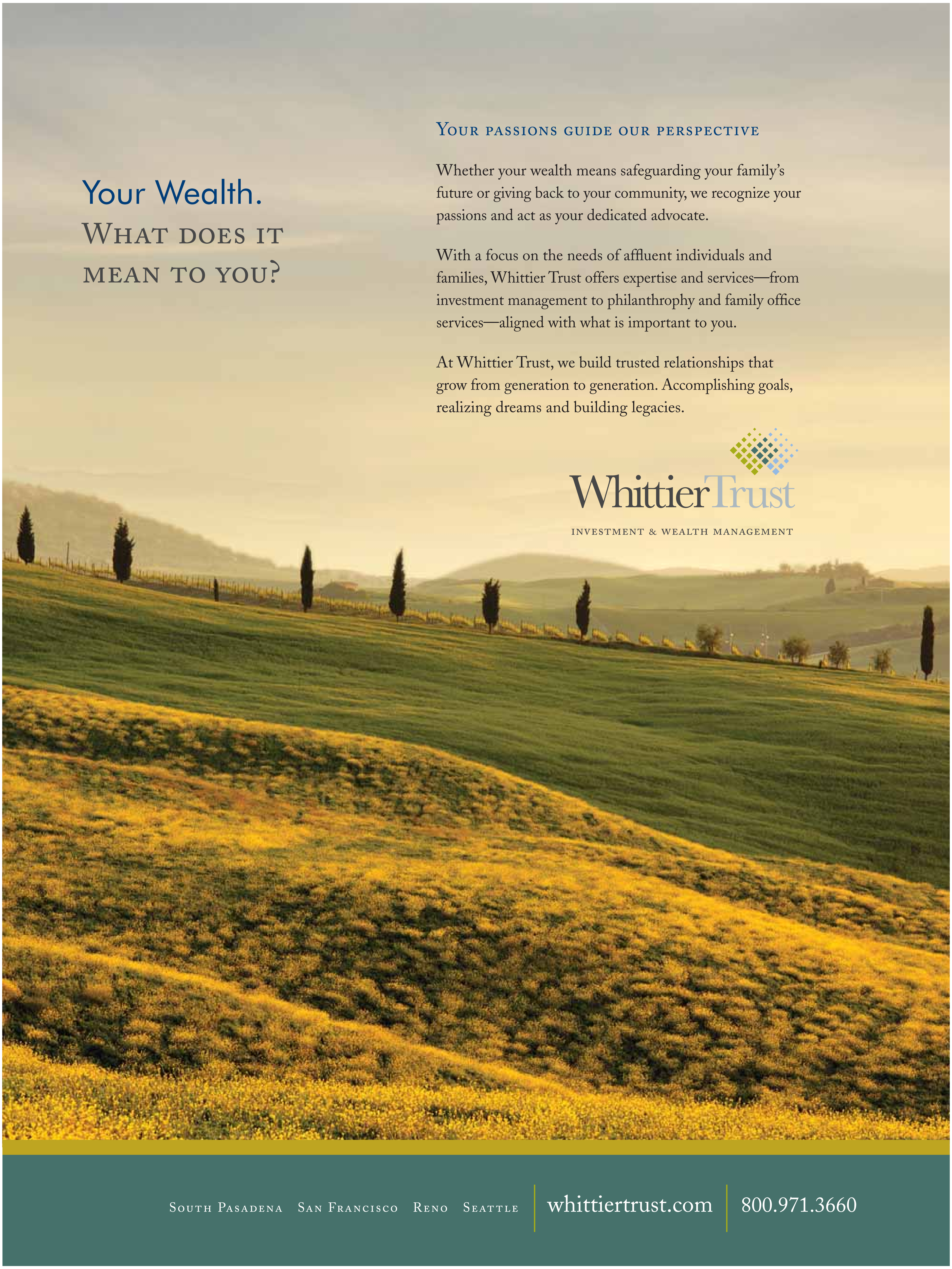
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Whether your wealth means safeguarding your family's future or giving back to your community, we recognize your passions and act as your dedicated advocate.
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WEALTH MANAGEMENT ROUNDTABLE

sors that can provide a continuity of planning services for younger generations.

◆ Do investors in social, environment and governance focused, or impact portfolios have to accept discounted investment returns in order to be invested in line with their values?

ALLEN-ATTAR: Conventionally, investors do view "doing well" and "doing good," i.e., investing in socially responsible portfolios, as tradeoffs. Morgan Stanley's "Investing with Impact" approach aims to generate risk-adjusted financial returns, while supporting positive environmental and/or social impacts. This investment style assumes that the environment, social and governance (ESG) risk that is ignored will eventually have a financial consequence, and come to play and impact financial performance. Sometimes, these ESG risks are called black swan events (an event that deviates from the norm) when they play out. For the ESG investor, these risks are not black swan events, but should have been factored into investment analysis all along. There is growing investor sentiment that a broadened analysis, which combines financial and ESG, may contribute to superior investment selection.

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SANFORD

A good example: some ESG portfolio investors, like Calvert, avoided the British Petroleum Deep Water Horizon disaster because they identified lax safety measures at BP before Deep Water Horizon.

◆ How do investors manage the complexities of the current investment market? Is there greater value put on advice?

DOSS: We believe there has never been a more complex environment for investors. Tax law changes have become more complicated, and the investment environment has become more challenging for conservative investors. This environment requires greater sophistication and complexity in the way portfolios are structured and managed. It also requires a team of advisors who can provide integrated advice across many disciplines.

SANFORD: Unfortunately, we live in a culture where market timing (when to be in and out of the markets and what sectors to be in and out of) and security selection (which stocks and funds to be in and out of) dominate the conversation. Worse, average investors are led to believe by some that they too can navigate the complexities of the financial markets just like the professionals. Yet countless studies have shown that do-it-yourselfers make the poorest decisions, because they allow emotion to drive their behavior. On the other hand, professional wealth managers maintain disciplined and objective processes designed to separate clients from their own emotions. By far, the greatest value should be placed on finding a wealth manager that you like, that you trust and whose advice will drive your financial wellbeing.

ALLEN-ATTAR: Advice is key! Morgan Stanley's consulting group has seen clients opt for an outsourced chief investment officer (CIO) model of investing. We believe that it is difficult to generate positive investment returns without a deep investment team. If you don't build that in-house, you should look at outsourced hiring of a CIO. The outsourced CIO model provides clients with a customized, discretionary investment solution that helps them meet their investment objectives and fiduciary obligations. In this model, the client asks the investment firm to manage the portfolio with full discretion over all aspects of the investment process, and holds that firm fully accountable. The outsourced CIO is not for the client who likes to be a stock picker or a trader, but quite appropriate for individuals and institutions whose boards have a strong sense of fiduciary obligation and require more timely advice. Among smaller endowments (endowments$50-$100million), over 90% have either an outsourced CIO or use consultants to provide investment advice.

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DOSS

◆ **What are the best basic strategies for risk-takers and conservative investors?**

SANFORD: At Boston Private Bank we view risk and volatility as synonymous. The amount of risk/potential volatility built into a portfolio should therefore result from its place in a person's overall financial plan. The less likely a portfolio will be used as a source of funds, the less the need for minimizing volatility and vice versa. Still, the importance of diversification cannot be overstated. Owning all long term treasuries, for example, might seem safe, but in a rising interest rate environment their duration would cause a significant drop in principal value. Likewise, a portfolio holding only a few stocks opens an investor to undue company-specific risk and consequently represents speculation not investing. Net/net the best strategy is to determine a portfolio's goal clearly and then work with an advisor to invest in those things which history and current market conditions have shown will achieve it most safely.