TAKING A COMPREHENSIVE APPROACH IN YOUR FINANCIAL LIFE

ACHIEVING FINANCIAL FREEDOM IN RETIREMENT

DECHTMAN
Wealth Management

Taking a Comprehensive Approach to Your Financial Life

MONEY MEANS DIFFERENT THINGS TO DIFFERENT PEOPLE. Each of us has different dreams. You may want to achieve financial freedom so that you never have to work again—even if you plan on working the rest of your life. You may want to make a top-level college education possible for your children or grandchildren. You might want to provide the seed capital that will give your children or grandchildren a great start in life, whether that's with a home or a business. You may dream of a vacation home on the beach or in the mountains. Or you may have achieved tremendous success throughout your career and want to leave behind an enduring legacy that will enable your favorite charity to continue its work.

Whatever your dreams are, you need a framework for making wise decisions about your money that will help enable you to achieve all that is important to you. Chances are good that you have a wide range of financial goals, as well as diverse financial challenges.

Common sense tells us that such a broad range of issues requires a broad comprehensive outlook. It's for this reason that most affluent clients want their financial advisors to help them with more than just investments. They want real wealth management—a complete approach to addressing their entire financial lives.

As you've probably noticed, many financial firms these days say that they offer wealth management. The trouble is that many of these firms just provide investment management and offer a couple of extra services—such as college education planning and estate planning—and call that wealth management. So the challenge for anyone who wants help addressing all his or her financial needs is finding a firm that provides true wealth management.

We define wealth management as a formula:

WM = IC + AP + RM

Investment consulting (IC) is the astute management of investments over time to help

achieve financial goals. It requires advisors to deeply understand their clients' most important challenges and then to design an investment plan that takes their clients' time horizons and tolerance for risk into account and that describes an approach that will help maximize clients' probability of achieving their goals. It also requires advisors to monitor both their clients' portfolios and their financial lives over time so that they can make adjustments to the investment plan as needed.

Advanced planning (AP) goes beyond investments to look at all the other aspects that are important to your financial life. We break it down into four parts: wealth enhancement, wealth transfer, wealth protection and charitable giving. In our experience, very few financial advisors offer these services.

Relationship management (RM) is the final element. True wealth managers are focused on building relationships within three groups. The first and most obvious group is their clients. To address their clients' needs effectively, they must foster solid, trusted relationships with them. Second, wealth managers must manage a network of financial professionals—experts they can call in to address specific client needs. Finally, wealth managers must be able to work effectively with their clients' other professional advisors, such as their attorneys and accountants.

Our focus in this resource guide will be on the first element of wealth management—investment consulting. But bear in mind that managing your investments is just one part of a comprehensive approach to your financial life. At the end of this guide, we'll describe what you should expect from a true wealth manager so that you can make an informed decision when choosing which financial professional to work with.

Let's turn now to our discussion of the concepts that can make you a more successful investor.

Rising Above the Noise

SOME INVESTMENT PROFESSIONALS MAY SEEM LIKE THEY ARE speaking a different language. As experts in their field, its easy to assume investors understand every term and concept, but frequently the jargon becomes confusing and even intimidating.

But investing is actually not that complicated. It can be broken down into two major beliefs:

- You believe in the ability to make superior security selections, or you don't.
- You believe in the ability to time markets, or you don't.

Let's explore which investors have which belief systems and where you should be with your own beliefs.

Exhibit 1 classifies people according to how they make investing decisions. Quadrant one is the *noise quadrant*. It's composed of investors who believe in both market timing and superior investment selection. They think that they (or their favorite financial guru) can consistently uncover mispriced investments that will deliver market-beating returns. In addition, they believe it's possible to identify the mispricing of entire market segments and predict when they will turn up or down. The reality is that the vast majority of these methods fail to even *match* the market, let alone beat it.

Unfortunately, most of the public is in this quadrant because the media play into this thinking as they try to sell newspapers, magazines and television shows. For the media, it's all about getting you to return to them time and time again.

Quadrant two is the *conventional wisdom quadrant*. It includes most of the financial services industry. Most investment professionals have the experience to know they can't predict broad market swings with any degree of accuracy. They know that making incorrect predictions usually means losing clients. However, they believe there are thousands of market analysts and portfolio managers with MBAs and high-tech information systems who can find undervalued securities and add value for their clients. Of course, it's the American dream to believe that if you're bright enough and work hard enough, you will be successful in a competitive environment.

EXHIBIT 1
THE INVESTMENT DECISION MATRIX

		Market Timing: Yes	Market Timing: No
Security Selection	Yes	**Noise Quadrant** 1 Most individual investors Financial journalists	**Conventional Wisdom Quadrant** 2 Financial planners Stock brokers Most mutual funds
	No	**Tactical Allocation Quadrant** 3 Pure market timers Asset allocation funds	**Information Quadrant** 4 Academics Many institutional investors

Source: CEG Worldwide.

As un-American as it seems, in an efficient capital market this methodology adds no value, on average. While there are debates about the efficiency of markets, most economists believe that, fundamentally, capital markets work.

Quadrant three is the *tactical asset allocation quadrant*. Investors in this quadrant somehow believe that, even though individual securities are priced efficiently, they (and only they) can see broad mispricing in entire market sectors. They think they can add value by buying when a market is undervalued, waiting until other investors finally recognize their mistake and selling when the market is fairly valued once again. We believe that it's inconsistent to think that individual securities are priced fairly but that the overall market, which is an aggregate of the fairly priced individual securities, is not. No prudent investors are found in this quadrant.

Quadrant four is the *information quadrant*. This is where most of the academic community resides, along with many institutional investors. Investors in this quadrant dispassionately research what works and then follow a rational course of action based on empirical evidence. Academic studies indicate that investments in the other three quadrants, on average, do no better than the market after fees, transactions costs and taxes. Because of their lower costs, passive investments—those in quadrant four—have higher returns on average than the other types of investments.[1]

Our goal is to help investors make smart decisions about their money. To accomplish this, we help investors move from the noise quadrant to the information quadrant. We believe this is where you should be to maximize the probability of achieving all your financial goals.

1 Michael C. Jensen, "The Performance of Mutual Funds in the Period 1945–1964," *Journal of Finance*, May 1968.

Mark M. Carhart, Jennifer N. Carpenter, Anthony W. Lynch and David K. Musto, "Mutual Fund Survivorship," unpublished manuscript, September 12, 2000.

Christopher R. Blake, Edwin J. Elton and Martin J. Gruber, "The Performance of Bond Mutual Funds," *The Journal of Business*, 1993: 66, 371–403.

Edwin J. Elton, Martin J. Gruber, Sanjiv Das and Matt Hlavka, "Efficiency with Costly Information: A Reinterpretation of Evidence from Managed Portfolios," *The Review of Financial Studies*, 1993: 6, 1–22.