SPECIAL REPORT

Wealth Management Exchange

Managing Your Wealth Wisely

SIX PROVEN STRATEGIES

How to ensure the financial well being of you and your family in an era of investment uncertainty.

Managing Your Wealth Wisely

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Strategy #1

Assume Accountability for Your Investment Portfolio and Wealth Management Plan

Affluent individuals need to acquire the knowledge to guide their advisors and monitor their performance.

"Our estates and investments are too important to completely hand over to someone else," says Wayne Cooper, the CEO and cofounder of Wealth Management Exchange. "Yes, we can delegate select functions like money management to those who have the training and experience, but, ultimately, we must monitor them, make sure that they are performing well, executing our plans and charging reasonable fees. We must retain the quarterback position."

To fulfill this mission investors shouldn't rely solely on the information provided by their closest advisors. In addition to the fact that many advisors have financial incentives to push certain products and solutions (e.g., their firm's proprietary funds or structured products), the world of investment and estate planning has gotten very complicated and no one person has all the answers. It is important to tap into a range of opinions on the key topics that need to be considered including:

Your asset allocation and portfolio management, global stock and bond investing;

Alternative investments such as hedge funds, real estate and private equity; estate planning;

Tax strategies, retirement planning, wealth transfer and more.

Fortunately, there are good sources of independent information available on the web such as wsj.com, money.cnn.com, Morningstar.com and WealthManagementExchange.com. These resources also serve as good sources of "second opinions" on investment advice affluent individuals get from their advisors and traditional information outlets.

Skepticism is Healthy

"We take a somewhat skeptical view of the recommendations accepted as conventional wisdom," says Cooper. While there are many trustworthy and experienced advisors, it is important to be an informed investor and client. "Just as you would want to oversee any decisions involving your physical health, and reserve the right to seek a second opinion if you are not 100% confident of your care provider's diagnosis, it is prudent to stay on top of your financial well-being."

It is also important to note that when it comes to investment knowledge, one size does not fit all. "It's up to you to remind your advisor that you expect an investment plan that applies to your specific situation and not one that is designed for different generic segments of the high net worth community—entrepreneurs and small business owners; professionals and senior executives; women and

heirs to wealthy families, among others," says David Beck, senior vice president and co-founder of the Wealth Management Exchange.

One of the first rules is coming to the realization that wealth management means a whole lot more than simply investing. Part of the process of gaining control over your wealth involves knowing that money, family and community all come together, and it's you that must manage the tradeoffs.

While your estate attorney might be expert at estate issues, your accountant and insurance agent might be great at estate tax minimization strategies, and your investment manager might excel at portfolio construction, allocations and monitoring, there also needs to be coordination among these various advisors. All too often, the lawyers, accountants and investment advisors are not coordinated with one another or the client's ultimate goals. While estate tax minimization should be part of an estate plan, it is not the ultimate objective. Figuring out how one's family and charities can benefit most from one's estate is the goal. Too many times, estate plans have driven families apart instead of bringing them together.

So it's not all about investing in the stock market or hedge funds. There are issues that must be faced including managing your estate, transferring wealth to your heirs, tax minimization, and charitable giving.

Your role is to manage the integration of these functions by managing the managers and taking control on your own.

Just how much control you want to take over your wealth management affairs depends on many variables, such as your own level of knowledge in wealth management issues, how much time you have available, your level of interest in the various topics, how complex and varied your plan needs to be, tax issues, and family considerations.

But one of the underlying factors should be just how much you want to depend on outside advisors. Several studies from the wealth management industry show that there are high levels of client dissatisfaction with their advisors.

Do All Advisors Look Out for Your Interests?

The way the wealth management industry operates today actually works against your interests, according to Stuart E. Lucas, chairman of Wealth Strategist Network and author of the book, "Wealth."

Barriers to Working with Wealth Managers

Lucas cites the following three barriers you face when working with wealth managers:

1. **Your wealth management goals and the goals of your advisors may not be aligned. If a conflict of interest arises, count on your advisor to put his own and his firm's interests ahead of yours.**

2. **Advisors don't always make the effort to understand the "personal and family dynamics" that drive your wealth management priorities and strategies. These could be crucial in framing business and investment decisions.**

3. **Perhaps most critical is the fact that many wealth management**

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professionals lack the breadth of skills and experience across the many investment, personal finance, tax and legal areas that will affect your finances. That means you will most likely have to deal with multiple advisors. The recommendations of one advisor should complement and reinforce the strategy of the other, but that doesn't always happen. Very often advisors work at cross purposes and you wind up being the loser.

For all of these reasons, more and more high-net-worth individuals are concluding that they must take control of their financial well-being and not cede it to others.

Fees: Lack of Transparency

Probably the number one issue leading to distrust of financial advisors is the lack of transparency regarding fees. It's important to understand how your advisor makes his or her money. People who used to be called stock brokers or insurance agents now often call themselves financial advisors or consultants, but they still have financial incentives to sell certain products to their clients. Some advisors will also push their own firm's mutual funds, hedge funds and structured products even when they are not competitive in terms of performance and/or fees. Advisors also sometimes get referral fees, so when one advisor recommends another, it's not always because the referred party is the best.

In addition to conflicts of interest, many high-net-worth investors have become skeptical of the fees they are being charged by their wealth managers. A 1% fee may not seem like a lot, but to pay $200,000 per year to an advisor to oversee a $20 million portfolio adds up quickly. And a 1% fee on a portfolio that yields 8% a year is actually a 12.5% charge.

"Ironically, although advisors may try to skirt the issue of fees, leading financial advisors interviewed for this report say that most of their clients aren't all that concerned about the absolute level of the fees. What they are concerned about is clarity," according to a report by State Street Global Advisors and Wharton.

While paying an advisor 1% (or more) may make sense for certain categories of investments where there is a large variance in performance (such as private equity, venture capital, hedge funds), and an advisor can earn back more than their fees by superior allocation and risk-management decisions, it is harder to justify this type of fee for basic stock and bond investing, especially now when there are good low cost mutual fund and ETF (exchange traded funds) options that provide good diversification and performance. The more control you have over your portfolio, or at least certain parts of it, the better you can direct investments towards those with low fee structures and save substantially.

Strategy #2

Set Ground Rules for Selecting And Working With Your Wealth Advisor

The wealth management professional has come a long way in the past 10-15 years. It used to be that many financial advisors cared much less for servicing their clients than pushing investment products that would bring them the highest profit margin.

While such "sales-oriented" financial advisors are still out there, most of the advisors that cater to high-net-worth individuals know they need to take their client's interest into consideration or they will soon be seeking other careers.

However, as more baby boomers near retirement age, financial advisors are being pressed to offer more solutions. As one financial expert put it recently, "It doesn't matter if someone is trouncing the S & P 500-stock index if he doesn't have enough money to retire the way he wants." For high net worth individuals, of course, a comfortable retirement is just a starting point. The efficient transfer of wealth to future generations and charities is also paramount.

That means advisors need to customize their services and offer more innovative solutions. While some advisors are moving in this direction, many cling to the old ways. To be candid, there are huge differences between the abilities of many financial professionals, so your search must be a comprehensive one.

It's impossible to say which of many qualities is **most** important but several stand out as critical.

First there is the issue of trust. You will be counting on your advisor to help you make many decisions regarding the enhancement and preservation of your wealth so it is obvious you will want to feel comfortable that the advisor will put your interests up front. If you suspect your advisor has conflicts of interest and is putting his own needs ahead of yours, it's time to look for another advisor.

Ethical behavior and integrity are essential. Your advisor will have access to personal information and private records about you and your family. You will want to be assured that this material is secure.

The issue of trust goes hand-in-hand with the issue of professional competence, expertise, knowledge and skill. The current investment climate is very complex. Gone are the days when the investment advisor's main job was to select some stocks, mutual funds and bonds. Today's wealth manager must have intimate knowledge of scores of investment vehicles and a working knowledge of many others.

Recent studies indicate that advisors may not be emphasizing their expertise enough. As the client, you have every right to demand proof that the advisor candidate is thoroughly knowledgeable. One way, of course, is to check credentials. Below is a list of various investment titles:

Strategy #2: Set Ground Rules

Wealth Manager Credentials

Chartered Financial Analyst *(CFA®)* **charter holder**
Certified Financial Planner *(CFP®)*
Chartered Financial Consultant *(ChFC®)*
Chartered Life Underwriter *(CLU®)*
Accredited Investment Fiduciary *(AIF®)*
Certified Investment Management Analyst *(CIMA®)*
Chartered Alternative Investment Analyst *(CAIA®)*
Accredited Estate Planner *(AEP)*

The highest credentials for wealth manager generalists are the CFA and CFP titles. Advisors have to take extensive courses (including continuing education courses) and pass rigorous exams to earn these designations.

Many high-net-worth individuals will ask some of their current trusted professional advisors, such as their attorney or their accountants, for recommended wealth managers. Others will seek the recommendations of their peers, and still others might contact a professional association for a listing of members such as the CFA Institute or the CFP Board.

Some investors will look at the top private banks or family offices to recruit their advisors, since these firms generally have a solid reputation. But there are no guarantees that the individual or firm you hook up with will serve your needs down the road.

Just a couple of decades ago, a fortune of $50 million was more than sufficient to justify creating a dedicated family office and directly employing a staff of accountants and investment managers to keep track of a family's finances, including the holdings of various trusts and foundations.

Today, the cost of talent and technology has pushed the break-even point for a dedicated family office to closer to $250 million and it is continuing to climb. Many former single-family offices have therefore grown into multi-family offices, offering unrelated families the ability to share a CFO, CIO, tax professionals and experienced administrative staff.

Services can include those of a wealth management firm (financial, estate and tax planning, investment consulting and manager selection) along with those of the traditional family office (bill paying, financial reporting, tax compliance, trust monitoring, charitable consulting, family counseling, and concierge services).

Fees range from hourly charges to monthly retainers to asset-based charges and/or some combination thereof.

Many high-net-worth individuals (HNWs) feel that their traditional providers do not offer best-practice solutions when it comes to strategic asset allocation, hedge fund manager selection, due diligence services, integrated tax planning, etc. Others feel that their advisors aren't bringing them the highest quality investment products available because their own firms don't sell these funds and/or have proprietary house funds that they're trying to push.

For these reasons, you might also seek to engage a family office or private bank with a solid reputation.

Strategy #2: Set Ground Rules

Here are the results of a recent poll of HNWs laying out their reasons for choosing their wealth manager:

Reasons for Selecting a Wealth Manager

Quality of Service	83%
Confidentiality and Security	75%
Quality of Investment Advice	67%
Image and Reputation	64%
Referrals from Current Client	56%
Investment Performance	50%
Pricing Products And Services	47%
Breadth of Product Range	44%
Access to Other Specialist Services	28%
Extent of Geographical Coverage	28%*
Family History	19%
Referrals from Business Introducers	19%

(Source: IBM Consulting Services, European Wealth and Private Banking Industry Survey, 2005)

Ask About Financial Reporting Practices

One of the most important issues you will confront in dealing with your wealth manager is how the firm provides reports on your investments. Increasingly, high-net-worth individuals are growing much more dissatisfied with the reporting techniques of their advisors.

In fact, according to a Merrill Lynch World Wealth Report 2006 study, "a client's inability to view asset holdings within a provider, managed by a third party or across various providers is one of the biggest levers for HNWs wanting to change firms or add independent advisors."

Specifically, one should make sure that the reports they receive are accurate and comprehensive. With investing becoming much more global and complex, some wealth managers are not providing the level of detail they should or making available the full range of investments.

You should also make sure your reports reflect your needs. Demand customization. Not all clients want the same reporting formats. You are entitled to have recommendations set up in the context of your own total net worth and asset allocation strategy.

Also, you should insist that your reports are clear. "Finding a way to meaningfully represent information in an understandable format that aligns back to their overall financial plan and wealth strategies will become a higher priority as investors diversify into new products and regions," notes the Merrill report.

Strategy #3

Fine-Tune Your Asset Allocation Plan to Meet Today's Complex Investing Environment

One of the most basic but often overlooked wealth management activities is the creation of an investment policy. The process begins with the collection of all relevant data about you, the investor. This would include basic financial data, investment objectives, risk tolerance, target rates of return, expected future cash flows, investment time horizons and investment constraints.

At this point, you would work with your wealth manager to develop an asset allocation plan that determines how the assets covered by the policy statement should be divided among the various asset classes—equity, fixed income, alternative investments, etc. You should also develop procedures for periodically reviewing your asset allocation plan and, if necessary, altering your strategy.

"Asset allocation" may be defined as the process of active selection among competing investment categories according to a scheme of diversification.

There has been a lot of research done on optimal asset allocations, also referred to as "modern portfolio theory." An ideal asset allocation maximizes return for a given level of risk tolerance determined to be acceptable to the investor. The excess of expected return over the risk-free rate, divided by unit of risk, is known as the "Sharpe Ratio," named after economist William Sharpe. Hence, another way to state the aim of an asset allocation program is that it seeks to maximize the Sharpe ratio of the portfolio.

On a practical level, there are five chief aspects to a portfolio allocation program, according to Andrew Szabo, managing director, Greenwich Financial Management Inc. The first is to define goals, such as risk level, return objectives, and time horizon. The second is to design a scheme for making tradeoffs among the goals. The third is to establish the set of investment categories among which allocations will be made. The fourth is to establish an initial balanced portfolio according to these parameters. The fifth is to rebalance the portfolio over time, either according to a definite rule or schedule, or ad hoc.

Most asset allocation schemes follow a "contrarian logic." That is, if a certain asset class starts to over-perform, a portion of its excess performance will be reallocated (i.e. by selling a portion of that asset class and using the proceeds to buy under-performing classes). This procedure is based on good evidence that asset classes tend to "rotate" in performance, based on shifts in investor preference or objective opportunities.

Natural resources may do well for one quarter or year, large cap U.S. equities another, European mid-cap equities next. This is why the practice of piling into funds with recent excellent performance (sometimes referred to as "chasing returns") often leads to heartache. Preferred investment styles also alternate. Although the "value style" (focused on stocks with low price-to-earnings, price-to-book value, price-to-sales or price-to-cash flow ratios) generally outperforms "growth," growth is sometimes favored, as it was in U.S. stocks during the early 1960s and again in the late 1990s. An authoritative source of data on sectoral performance is Ibbotson Associates (see www.ibbotson.com).

The main advantages of an asset allocation program are typically risk reduction (measured in terms of volatility of returns) and greater likelihood of achieving the long-term returns.

Strategy #3: Fine Tune Your Asset Allocation Plan

The main disadvantage is the danger of leaving an asset class (in whole or part) too early, while it continues to outperform for some time to come—a condition that has aptly been called "asset envy." See David Darst, "The Art of Asset Allocation" (New York: McGraw Hill, 2002). Think of sitting out the year 1999 with a minimal allocation to high tech, while your friend brags of stellar Cisco returns. A related disadvantage, inherent in any diversification effort, is likely failure to achieve the theoretical returns possible when a highly concentrated portfolio is managed with great success.

There's no shortage of industry and academic literature on how to design portfolios using traditional asset classes. Today there are a wide variety of traditional investment asset classes available to advisors to include in their clients' portfolios. Within each traditional asset class, your advisor can further diversify between growth and value, says Thomas A. Orecchio, CFA, CFP and Principal, Greenbaum and Orecchio, Inc., Old Tappan, New Jersey.

Your advisors can manage risk in a variety of ways, and can choose from a number of different market sectors. In addition, advisors can choose from two different management strategies for these traditional asset classes. For the asset classes they believe are efficient, they can use passive management such as indexing. For those asset classes they believe are inefficient, they can use active management, and choose between security selection and market timing.

Advisors understand the rather straightforward process involved in the implementation of traditional asset classes in client portfolios. Whether they are pooled products (such as mutual funds, ETFs or indexes), or individual securities, traditional asset classes offer the following benefits:

- **Low transaction costs**
- **Very liquid secondary markets**
- **Readily available public information**
- **Numerous custodians offering value-added services**
- **Extensive regulation to ensure a relatively level playing field**

Since investors are generally familiar with these products, their performance, and their marketplaces, they are usually comfortable investing in traditional asset classes. Some advisors manage traditional asset class portfolios using separately managed or WRAP accounts. Most traditional products are available on a take it or leave it basis, not offering clients or advisors an opportunity to negotiate any details such as time horizon, risk level, collateral or even their basic structure.

Traditional asset class marketplaces are highly structured and regulated. Most traditional asset class securities are traded on secondary exchanges such as the NYSE or NASDAQ, resulting in easy valuation and offering high liquidity.

Combining pairs of investments in which the two members historically have gone separate ways is what smoothes the path of the combination over time. The extent to which assets move together is termed "correlation." The highest possible correlation coefficient is 1.0, which means that whatever one asset class does, the other does precisely the same thing at the same time. A zero correlation, then, is one is one where there is no relationship between the two assets' behavior patterns. A correlation of minus one means that whatever one asset does, the other simultaneously does the opposite.

"Any correlation of less than 1.0 provides some diversification, and the further from 1.0, the greater the benefit," according to a report, "Fortune and Misfortune, Investment Planning to Achieve One and Avoid the Other," by Alliance Bernstein.

Strategy #3: Fine Tune Your Asset Allocation Plan

The Rise of Alternative Investments

Alternative Investments is a term given to investments that are not mainstream investments, such as traded stocks, bonds, Treasury, and Certificates of Deposit (CDs). As these alternative investments become popular and get a mass following, they tend to join the mainstream. Included in this asset class are investments such as private equity, hedge funds, commodities, and real estate. These investments often lack liquidity, and have a long-term time horizon. Also, these tend to be black-box investments with limited access to performance and investment information. These investments are not regulated by the SEC.

The trend toward allocating more funds toward alternative assets classes took hold originally with institutional investors and the major higher education endowment funds such as Harvard and Yale. A study by the National Association of College and University Business Officers revealed that the portion of investments in asset classes other than equities and fixed income more than tripled—from 5.4 percent to 17.3 percent of investment portfolios over the past 10 years.

The percentage continues to climb year after year as the endowments and institutions realize better returns from such investment classes as hedge funds, private equity, real estate and natural resources.

To be sure, most private investors lack many of the advantages, including the huge financial resources, available to the university funds. Still, wealth managers continue to move clients into the alternative classes.

One of the major justifications for this trend is portfolio diversification. One alternative class, managed futures, has zero correlation to the overall market. Hedge funds vary by investment strategy and style, but most hedge funds have lower correlations to the overall market.

In addition, alternative investments, while risky in themselves, complement a traditional portfolio in reducing the portfolio's overall risk. On the down side, some investors are put off by alternatives because they are largely unregulated and lack the overall transparency of traditional classes.

In addition, there have been some well-publicized hedge fund failures, such as Amaranth and the huge drop-offs experienced by some of the Bear Stearns hedge funds.

The Case Against Including Alternative Asset Classes In Your Portfolio

All is not rosy when it comes to including alternative investments in your portfolios. Here are some of the problems an advisor must deal with:

High minimum investment size. Many alternative asset class products are limited to a maximum of 99 investors. Since general partners *(GPs)* controlling these products earn more fees if they manage more money, many require a $1 million minimum ticket size. How would this limit affect you as a client? Here's an example: if a client with a $4 million portfolio had 10% allocated to private equity, then that client would have $400,000 available to invest in that asset class. Assume that the advisor wanted to further diversify the client within the private equity asset class, into four different private equity limited partnership products. The client would have $100,000 on average to invest in each of four private equity deals. Since that is less than $1 million minimum, the client could not invest in those products, says Orecchio.

Poor diversification within each asset class. Limited overall portfolio size and high minimum investment size also limits diversification <u>within</u> each asset class. This introduces some non-systematic risk, a type of

risk for which you, the client, are not compensated.

Excessively high annual expenses. Investors typically have to pay "2 and 20" to own alternative asset class products. This means they have to pay the general partner running the deal twice: (1) annually 2% of assets under management, and (2) 20% of each dollar of profits. Once an alternative asset class deal generates a 12% annual return, the clients' total annual cost of ownership would be between 6% - 8%, including trading costs, interest expenses on leverage, administrative expenses and management fees. By comparison, an investor's total annual cost of owning a typical traditional asset class product is between 1% and 2%. Taxes can make alternatives, particularly hedge funds, even more expensive since much of the gains generated by actively traded accounts are taxed at ordinary income rates vs. long term capital gain rates.

High due diligence costs. Due diligence costs can be expensive, since they can include the cost of investigative trips, technology, negotiations, professional time and expertise, plus outside investigative, legal and accounting services. Both qualitative and quantitative due diligence are required. There is no comprehensive list of alternative asset class products available to the advisor. Using hedge funds as an example, here are some of the difficulties of performing due diligence:

There are well over 11,000 hedge funds available today, compared with about 14,000 mutual funds invested in traditional asset classes. Hedge funds are only one of the alternative asset classes available.

There is currently no requirement for registration as an investment advisor for the people who run alternative asset class products, although the SEC is currently evaluating this issue.

There is also currently no requirement for performance reporting.
No one knows about all the alternative asset classes and products out there, or how they are performing.

Difficulty finding a custodian, especially for IRAs. Broker/dealers and banks are often reluctant to custody alternative investment products. There are no standards for the transfer of ownership and subscription documents *(evidence of ownership)*, so it must all be done manually, and is therefore more expensive for custodians to maintain.

Challenges in providing clients with tax information. Tax reporting is difficult, with K-1's and restatements.

Burdensome regulation and statutory compliance issues. There are seven applicable regulatory and compliance areas: Securities Act of 1933, Securities Exchange Act of 1934, Investment Company Act of 1940, Investment Advisers Act of 1940, Commodities Exchange Act, Internal Revenue Code, and State securities statutes and regulations.

Advisors' lack of familiarity. Many advisors have limited experience when it comes to alternative asset classes. A new professional credential, the Chartered Alternative Investment Analyst *(CAIA®)*, is now available. The CAIA is patterned after the Chartered Financial Analyst *(CFA®)* credential, which focuses on traditional investments. The advisor working towards the CAIA designation is tested for knowledge of the CFA ethics standards. The CFA includes three exams, while the CAIA has two. About 300 advisors have already received their CAIA certification. The requirements for the CAIA credential are quite rigorous and the tests are difficult. The prep time for the CAIA is comparable to the CFA.

Investor misconceptions and fears. Some investors fear the unknown. They put too much importance on recent results and fear large losses. The media inundates them with stories of doom and gloom. Everyone has heard the old horror stories from the 70s and 80s about limited partnership alternative investment deals that failed. Non-producing oil wells. Panned-out gold mines. Abandoned housing projects. Broken

promises. Lost savings. Rather than a pot of gold at the end of the rainbow, alternative investments offered many spectacular failures. Focusing investors on the truth takes time, patience and education.

The Plus Side of Including Alternative Asset Classes In Client Portfolios

In spite of the negatives, many financial advisors see major benefits for their clients in structuring portfolios containing a balance of traditional and alternative investment products. Here are the positives they see, observes Orecchio:

- **Innovative investment strategies**
- **Choice of active or passive management**
- **Significant improvement in portfolio diversification**
- **Enhanced liquidity**
- **Better tax management**
- **Reduced portfolio risk**
- **Customization**
- **Solid governance and business management structure.**

Still, many advisors don't believe alternative investments can deliver these. Overcoming those misconceptions will also take time and education. These obstacles have caused many advisors to avoid putting alternative asset classes in their clients' portfolios. While including alternative investments in client portfolio is difficult, the potential for increased diversification, higher return and reduced risk makes the trouble worth the extra effort.

At one financial planning firm, for example, Greenbaum and Orecchio Inc., clients can choose from among six different alternative asset class series in client portfolios. These include: private loans and mortgages, venture capital and private equity, energy, real estate, market neutral, and other (timber, metals, water, etc.).

Four Benefits of Hedge Funds

Greenbaum and Orecchio Inc., specifically uses hedge funds because they offer these four major benefits over traditional investment asset classes:

- **Including hedge funds in a balanced portfolio adds diversification, reduces overall portfolio risk and volatility, and can increase returns.**

- **Hedge funds have the ability to generate positive returns in both rising and falling markets.**

- **The large variety of hedge fund investment styles – many uncorrelated with one another – provide investors with a wide choice of investment strategies to meet their investment needs.**

- **Hedge funds provide clients with the greatest degree of liquidity among all the alternative investment asset classes.**

Strategy #4

Take a Global Approach to Stock and Bond Investing

The growth and performance of the emerging/international markets is a wealth trend investors cannot overlook. The Dow Jones World Stock Index, excluding the U.S., rose 23% in 2006, compared with 16.3% for the Dow Jones Industrial Average in the U.S., and has outpaced the U.S. market for the past 5 years.

More recently, in the second quarter of 2007, The Dow Jones World Emerging Markets Index gained 15%. Corporate profits are on a roll in many European countries and have outpaced analyst predictions in Asian countries as well.

Global Performance by Industry Group

Five Top Performers	Five Worst Performers
Aluminum	Home Construction
Coal	Real Estate Investment Trusts
General Mining	Gold Mining
Commercial Vehicles and Trucks	Travel & Tourism
Oil Equipment and Services	Nondurable Household Products

(Source: Dow Jones Global Indexes)

Most recently, the U.S. stock market has been characterized by volatility. While the second quarter of 2007 saw strong results and the Standard and Poor's 500-stock index and Dow Jones industrial average set record highs in July of '07, a market correction and higher volatility came back in August. Given climbing bond yields, problems in the housing and mortgage markets, rising oil prices and huge trade and government spending deficits, the future of the U.S. market is uncertain.

A key factor that has driven the recent market run-up has been strong corporate earnings of U.S. firms. Yet some observers are quick to point out that many of the large cap firms that have reported record profits and revenues are benefiting from the weakened dollar and robust sales abroad. Just how long corporate earnings will continue to soar is anyone's guess.

A growing number of U.S. money managers believe U.S. stocks are overvalued. The Russell Investment Group's quarterly Investment Management Outlook noted that 17% of managers say U.S. stocks are overvalued, the highest level in three years.

On the other hand, half the money managers are bullish on emerging markets stocks (up from 39% early in 2007). Still, some money managers worry about the risks. "We've really limited our exposure to the emerging markets in recent quarters, said one financial advisor. "We don't feel like we are getting compensated enough to take on the additional risk."

Strategy #4: Take a Global Approach

Following a nearly five-year run dating from 2002 lows, the stocks of emerging markets are the flavor of the year. So should investors be pouring money into this asset class on the theory that the developing economies will grow faster than those of the developed world? Or do they represent too much risk for even the average high-net-worth individual? The best answer is that emerging markets countries (and companies) come in all shapes and sizes, and some of these stocks are worthy of being included in most peoples' portfolios.

This kind of investment can make sense, because countries tend to specialize along the lines of "comparative advantage" or the "international division of labor," according to Tom Au, financial expert and author of "A Modern Approach to Graham and Dodd Investing." That is, America might have the fastest-growing software companies in the world, while Mexico has the fastest growing cement companies. That's because America is relatively well-endowed with intellectual property and poorly endowed in low-cost skilled labor, while Mexico's situation is basically the reverse. A portfolio diversified by industry might include both Microsoft and Cemex.

On the other hand, some people want to invest in emerging markets because they are emerging, and presumably faster-growing and more remunerative than developed markets. In that case, you may want to concentrate on companies that serve the growing local markets vs. export-focused companies.

Industries that serve this purpose include banking, consumer goods, and, above all, telecom. If you want a play on China, you might consider China Mobil Telecom; for Hungary, the local phone company would be Magyar Telecom. But the flip side can also hold: political or other adverse developments in a country could also make its stocks riskier than its global, or even emerging markets counterparts. Venezuela Telecom was recently a case in point because of the country's moves toward "nationalization" of key industries, including telecom.

In fact, emerging markets fall into several different risk categories. The first is a class of almost-developed markets, such as Chile, China, the Czech Republic, Hungary, (South) Korea, Malaysia, Mexico, Poland, and South Africa. These are countries whose sovereign bonds are rated "investment grade" by the rating agencies such as Moody's and Standard and Poor's. Investment grade ratings mean that the countries are very safe in relation to other emerging markets, and not that much riskier than developed markets, according to Au.

Such markets could form one end of a risk continuum that starts with the United States at the top, Western Europe and Japan just below, peripheral developed markets like Australia, Canada, and Sweden in the middle, and the investment-grade emerging markets below that.

The second group consists of "core" emerging markets, whose countries have bonds just below investment grade, but which are considered to be well in the mainstream by emerging markets standards. These include most of the larger South American countries, such as Argentina, Brazil, and Peru, as well as Eastern European countries such as Russia, and some of the larger Asian markets such as India, Indonesia, and the Philippines. (Colombia in Latin America, and Thailand in Asia are on the border between this group and the one above.) Turkey is probably the only one of the Africa/Middle East countries that qualifies at the low end of the emerging markets mainstream.

The third group includes peripheral emerging markets. Most countries in Africa (other than South Africa) and the Middle East (other than Turkey) fall under this category, as well as smaller countries like Ecuador and Bolivia in South America. These are exotic markets that are best left to the real experts and are not recommended for most of us. Many banks and investment funds are trying to get into some of these exotic markets because they have been hot recently, thereby playing "catch-up," and some of them will get burned.

Strategy #4: Take a Global Approach

Emerging markets as a group may rise two or three times faster than developed markets as a group, but the flip side is also true: emerging markets also fall two or three times faster on the downside, notes Au. Hence, an investor needs to exercise greater than usual care in trying to tap them. Selectivity is the key, both as to the market, and to the vehicle itself.

What About International Bonds?

International fixed-income securities offer two important benefits to U.S. investors: the potential for greater returns and broader diversification than domestic bonds can provide. Because interest rates in some foreign countries are higher than domestic rates, certain foreign bonds pay higher yields than U.S. issues. In addition to the interest rate risk and credit risk that all bond funds have, foreign bond funds are subject to currency risk. Funds that invest in emerging market securities are also vulnerable to political and economic instability and the potential illiquidity of these markets.

Goldman Sachs Report: Following the Smart Money Internationally

The conclusion of a recent study by Goldman Sachs comes as no surprise to many: U.S.-based portfolio managers of large-cap mutual funds are increasing their exposure to non-US equities. Retail investors have followed right along, with large inflows of assets to mutual funds earmarked for international stocks.

Just how dramatic is this increase? Foreign stock holdings now account for 8.4% of total equity assets of a typical U.S. based mutual fund compared with just 1.2% in 2000, according to the Goldman report.

Large and small investors alike still have doubts about Asia. While we have all heard of the enormous growth of emerging countries and economies in Asia, most of the investment action continues to be focused on Europe and non-U.S. North American companies.

Asian markets are largely avoided by large-cap value managers in the U.S., who tend to focus on the Western hemisphere. U.S. large cap growth managers also have a European bias and have six times as much capital earmarked for Europe vs. Asia (excluding Japan); that is 4.7% vs. only 0.8%. And even the allocation to Japanese securities is a mere 0.4% allocation.

Will there be a change in Asia investor sentiment in 2007? True, '06 was a very good year. "The re-rating of the region's stock markets—which saw India, Singapore, Hong Kong and Australia scale record highs over the year—was matched by healthy inflows from foreign institutional investors, with more than $13 billion worth of funds estimated to have made its way into Asia, ex-Japan," notes a report by Aberdeen Asset Management, of the UK.

Many forecasters believe Asia will remain a good bet for the remainder of 2007 but that depends on global investor sentiment. Aberdeen says Asian economies have been "delinked" from the U.S. but a "sharper-than-expected slowdown in the U.S. is bound to have an effect on the region."

So which are the foreign companies that have attracted the most attention of large mutual fund investors? In order:

Nokia
Roche Holdings
Alcon
Novartis
BP
Diageo
TOTAL
Nestle
GlaxoSmithKline
SAP
(Source: Goldman Sachs)

Here are some other trends worth noting, according to the Goldman research analysts:

U.S. large-cap value funds have an abundance of exposure to foreign energy companies including BP, Royal Dutch Shell and Total.

Large-cap U.S. growth funds have significant exposure to foreign telecom services, health care and materials. While the telecom sector accounts for only 1% of total portfolio holdings, foreign stocks represent 49% of growth fund holdings in the telecom sector. An average of 15% of health care holdings are invested in foreign stocks by U.S.-based growth managers.

Overall, foreign stocks usually account for between 5% and 15% of holdings of each sector in large-cap U.S.-based mutual funds.

Look at a Wide Range of Global Investments

In the final analysis, diversification demands that you consider allocating to international stocks, some in developed countries such as Europe and others in strong developing nations like China, India and Brazil.

A recent study found that more than half of wealthy American investors believe U.S. markets are riskier than international markets. Average investors will own at least one foreign fund in their individual retirement accounts or 401(k).

Said one financial expert, "It's important to know that international funds in general should not be thought of as substantially risky investments. The key is finding out what kind of international fund it is, in the same way as you would a fund that invests in the U.S."

Strategy #5

Solidify Estate and Legacy Planning To Preserve and Transfer Your Wealth

An estate is the total property, real and personal, owned by an individual prior to distribution through a trust or will. Real property is real estate, and personal property includes everything else, for example, cars, household items, and bank accounts. Estate planning distributes the real and personal property to an individual's heirs.

Estate planning is the process by which an individual or family arranges the transfer of assets in anticipation of death. An estate plan aims to preserve the maximum amount of wealth possible for the intended beneficiaries and flexibility for the individual prior to death. A major concern for drafters of estate plans is federal and state tax law.

Wills and trusts are common ways in which individuals dispose of their wealth. Trusts, unlike wills, have the benefit of avoiding probate, a lengthy and costly legal process that oversees the transfer of assets. Sometimes, though, it will be useful to make *inter vivos* gifts (gifts made while the donor is alive) in order to minimize taxes.

Estate Planning Tips

Make sure to prepare a will. Be sure it keeps pace with changes in your own personal circumstances and adjustments in tax laws. Marriage, divorce, birth, a move to another state or a change in your finances should signal an immediate review and possible updating of your will.

Also keep in mind the estate tax and the estate tax exemption. The estate tax, or death tax, is 55% for larger estates. The IRS allows U.S. citizens to pass the first $2 million of assets in 2006-2008 (increasing to $3.5 million in 2009) to their beneficiaries, free of federal estate tax. Be sure to plan properly so that both spouses use their estate tax exclusions.

Unfortunately, Congress has been unclear as to what it plans to do about the estate tax. Said one financial planner, "By far the most important estate planning issue faced by clients and planners alike is the future of federal estate tax."

What's especially confusing is that, as it currently stands, in 2010 the tax will be lifted completely but reinstated in 2011 at up to 55% on estates over $1 million.

It is uncertain what will happen next. Republicans want to eliminate the tax altogether but that is not very likely given that Congress is controlled by Democrats. Regardless of what Congress decides to do, the following are useful tactics to reduce estate taxes:

How to Reduce Estate Taxes

1) Take Advantage of Lifetime Gift Exemptions. Many high-net-worth individuals have reduced their estate

taxes significantly by giving away some of their estates while they are alive. The federal gift tax exemption permits a person to give away a lifetime total of up to $2 million to family, friends or others without paying federal tax. You can also give away annual gifts of $12,000 (Spouses together may gift up to $24,000) to each beneficiary per year without having to pay gift tax and without eating into your lifetime gift tax exclusion.

While it is true that each individual has the right to leave $2 million without incurring estate taxes, the rules for gifting are somewhat different. Under the current rules, each person can only gift up to $1 million while they're alive without having to worry about paying gift taxes. While this may create additional complications, it may still be a good idea to gift away assets while you're alive, especially assets that could appreciate greatly. This way, all of the future appreciation could take place "outside" of your taxable estate. Like all other aspects of estate planning, considering an appropriate gifting plan is important. Make certain that you coordinate each of the various aspects of your overall plan so that you don't run afoul of the rules.

2) Use GRATS. GRATs (grantor retained annuity trusts) have grown as a way to give away appreciating assets to family and friends and avoid estate taxes on the transferred assets. Needless to say, all this uncertainty has a put a premium on the sound advice of good estate planning professionals.

3) Title Assets to Avoid Probate. Holding property in joint tenancy with right of survivorship is a simple way to avoid probate. Joint tenancy with the right of survivorship is a form of property ownership by two or more people. When one of the joint tenant owners dies, his/her interest in the property automatically passes to the surviving owner(s) without triggering estate taxes, says Joshua Frankel, CFP, and second vice president, wealth management, Smith Barney.

4) Monitor Retirement Plan Assets. If you plan to gift your IRA or qualified plan to heirs at death, the account could lose up to two-thirds of its value to federal estate and income taxes. Taking distributions from your IRA or qualified plan and purchasing a life insurance policy held in an irrevocable life insurance trust (ILIT) could be a consideration. That way, your heirs receive the insurance death benefit free of estate and income taxes (if the ILIT and plan are properly designed), instead of a fraction of your IRA or qualified plan. Another option is to fund charitable gifts from your IRA and avoid the double tax on an IRA redemption and gifting.

5) Plan to Have Enough Liquid Assets to Satisfy Estate Taxes. Generally, the IRS requires that any federal estate tax liability be satisfied within nine months of the date of death, and that payment must be in cash. There are four typical sources from which funds can be obtained: cash reserves, loans, and liquidation of assets or life insurance proceeds. Good cash or insurance planning can protect your heirs from having to liquidate real estate, a private company or other assets you'd prefer to keep in the family.

6) Hold Life Insurance in Trust. If properly owned by a trust or third party, life insurance proceeds may be income tax-free to the recipient and not subject to estate tax. However, the proceeds will be subject to estate tax if you (as the insured) own or have rights in the policy. Purchasing the policy within an irrevocable trust may prevent life insurance proceeds from increasing your estate tax liability.

7) Know What You Have and Where You Have It. Keep copies of your important papers and make sure that appropriate parties know where these papers are kept.

8) Meet with Your Financial Advisor. Finally, discuss your estate planning objectives, concerns and fears with your financial advisor, as well as your tax and legal advisors, so that you can develop a plan for effectively transferring wealth to your heirs.

Preparing Adult Children for Inheritance: Selecting a Trusted Trustee

Many parents establish trusts as vehicles for conserving their estates, reducing taxes and providing for charitable giving. Trusts, in particular, make enormous sense for children under age 21. Similarly, trusts can be highly appropriate for young adults in their 20s or 30s, while they may be less appropriate for older, more responsible adults.

Because assets are held in the trust and distributed from it according to the wishes of the trust's creator ("grantor" or "settlor" or "trustor"), parents who create trusts find comfort in knowing that their children and grandchildren will benefit from a properly managed inheritance, according to Joe Calebrese, the executive vice president and head of the private wealth group, Harris Private Bank

Trustees play a critical role. When parents are no longer capable or no longer living, trustees function as the family's CEO and CFO. They gather information about the family and its members, and they offer guidance to children and grandchildren. Critically, the trustee manages the investments held in trust for the benefit of the children (or beneficiaries), a task that can overwhelm even the most mature and knowledgeable of children, says Calebrese.

A responsible child with a $100,000 annual income may not have the time, experience or desire to manage a $20 million estate. The trustee assumes the burdens of this responsibility, leaving the children free to enjoy the benefits and fruits of their inheritances.

Who Should Parents Select as Trustee?

According to Calebrese: "Parents can choose one or more individuals, a corporate trustee, or a combination of the two. Selecting a family member often can present risks, despite the fact that a family member often will not charge a fee for his or her services as a trustee. The risks include overburdening the family member/trustee with difficult decisions regarding investments, the timing of distributions to beneficiaries and the amounts of those distributions. Individual trustees who are family members often get caught between family members' competing desires, which can result in faltering family relationships."

Corporate Trustees Positioned to Treat All Beneficiaries Fairly

On the other hand, corporate trustees are not related to the beneficiaries and their professional experience and expertise positions them well to treat all beneficiaries fairly and with impartiality. Corporate trustees also provide continuity: While an individual trustee may become ill and unable to act — or may die — a trust company can continue to act for generations.

Another benefit of corporate trustees is that corporate trustees are guided by statutorily adopted "prudent investor" rules that prescribe the exercise of reasonable care, skill and caution as well as a general duty to diversify the trust's investments. Corporate trustees must also be mindful of the provisions of the trusts they administer — not only provisions that relate to investments held in the trust, but also to provisions that

inform the trustee that the interests of both current and future beneficiaries must be protected.

In addition to the management and diversification of trust assets, a corporate trustee assumes direct responsibility for a complete range of services including trust administration, preparing trust tax returns, acting as a family advisor, administering the trust according to its terms and managing closely held businesses and non-marketable trust assets.

Strategy #6

Prepare for the Challenges and Enjoyment of Retirement

No matter how advanced you are in planning your retirement investment strategy with your advisor, it is critical not to lose sight of the four factors below. Your advisor should be addressing them as he or she consistently monitors your plan.

Retirement Planning: Four Factors to Consider

Factor 1, Inflation: Inflation poses two challenges. First, it makes it tougher to accumulate sufficient resources in advance of retirement. Second, inflation makes it tougher to keep up with the steadily increasing living costs throughout a long retirement.

One of the biggest mistakes people make in planning for retirement is to ignore or underestimate the effects of inflation. Even though inflation is much lower now than in the double digit years of the late 1970s and early 80s, it still takes its toll on your purchasing power, according to Jonathan Pond, investment specialist and author of numerous books including, "You Can Do It!: The Boomer's Guide to a Great Retirement."

By way of comparison, the average annual inflation rate during the 1980s, which included some very high rate years was 4.7 percent. During the 1990s, a decade of supposedly much lower inflation, inflation still averaged 3 percent per year.

While a 3 or 4 percent inflation rate may seem low, it means that the cost of living will double every 18-24 years. And who knows, with energy and other prices rising, whether we will see a much higher rate to come. This means retirees are likely to see the cost of living double—or more--during their retirement years.

Factor 2, Life Expectancy: Since the beginning of the last century, longevity has increased dramatically and continues to expand given the progress of advancements in health and medicine, notes Pond. Now a person who retires at 65 may be able to live another 25 years; many will live beyond that. You may work for 35 to 40 years during which time you will have to accumulate enough retirement funds to last 25 years or more. If you retire early, you could spend as many years retired as you did working.

Factor 3, Great Expectations: Most of us have ambitious retirement expectations—we expect to maintain the same style of life when we retire as we had during our working years, says Pond.

Previous generations expected to cut back somewhat when they retired and didn't expect to retire before age 65. There is nothing wrong with you setting high retirement expectations—as long as you are ready to take the actions necessary to achieve them.

Factor 4: Core Needs and the Extras. In planning your retirement, you need to consider overall objectives in light of your broad retirement needs. They basically fall into 2 categories. One consists of core needs—maintaining a desired lifestyle and allocating funds for emergencies. You and your spouse want to be sure your basic needs are covered.

Strategy #6: Prepare for Retirement

Then there are the extras or excess capacity. These include transferring wealth to the family, extra spending for you and your spouse, increased charitable giving and community activities, etc.

Most financial planners will advise their clients that when investing for retirement, plan for the worst. That is, assume the capital markets will be in a depressed state just to be safe.

Because you cannot replace retirement assets since earned income is no longer available, you may be tempted to move much of your portfolio into relatively safe investments like bonds. If you pursue this conservative investment approach, you may be trading some of the better growth potential of stocks for more dependable income of bonds.

As an example, assume you had $5 million to invest between 2000 and 2005 and you invested in nothing but municipal bonds. The bonds grew at an average annual rate of 5%, which means that you would have earned $250,000 in annual income without depleting your capital or increasing your capital base. That's not bad, but if you would have taken the same amount and invested in an aggressive growth stock portfolio over the same period of time, you would see 40% of your capital consumed by the bursting of the high tech bubble.

Of course, these are exaggerated examples. Most investors know not to put all of their eggs in one basket. Basic asset allocation principles still apply.

"Despite the short-term risks of owning stocks, we'd usually advise against a portfolio allocation heavily skewed toward bonds," notes Alliance Bernstein in a recent report, *Leisure Doesn't Always Come Easy*. "The problem with overdependence on fixed income investments is that a retirement portfolio should be designed to ensure a client's financial well-being for decades—not years—and therefore needs to generate growth, not just income."

Diversifying Your Portfolio for Prudent Retirement Preparation

Keeping pace with inflation, without eroding your principal, probably should be the goal of most people.

So, how do you do that?

There's no magical formula: A common sense approach to investing can do the trick. It's all about diversification. If you spread your investments around, you're also spreading the risk. If one asset class tanks, that's OK – you'll also likely be investing in a booming segment, says P.J. DiNuzzo, founder, president and chief investment officer of DiNuzzo Investment Advisors, Inc.

"Start off with a growth portfolio consisting of about two-thirds stocks and one-third bonds. Establish a core of passive investments; index funds work great because there are far fewer chances for an investor to outsmart the market himself," advises DiNuzzo.

Consider that over the past decade, institutional investors (who rely heavily on index funds) cleared an average annual return of 11%. In comparison, individual investors pulled in just 6% per year.

The next step is to maintain appropriate diversification. "Make sure your portfolio is exposed to U.S. large-cap funds, U.S. small-cap funds, real estate investment trusts (REITs) and U.S. value funds. International

stocks are important, too. At least a fourth of any portfolio stock allocation should include international equities. Make sure to get exposure to large- and small-cap issues, as well as value stocks and those from emerging markets.

Exposure to commodities will help keep a portfolio on an even keel. The AIG Commodities Index is a sound way to access those often-confusing markets," says DiNuzzo.

"Let's turn now to bonds, which should comprise the remaining third of a portfolio. Always select investment-grade bonds and never choose any with terms greater than five years", says DiNuzzo. He further advises, "Make sure to 'ladder' your portfolio with bonds having terms of one to five years. That way, some bonds are always maturing, giving you the chance to take advantage of higher rates when they're present, while also minimizing your exposure to periods when interest rates are lower."

Laddering is akin to a concept called dollar-cost averaging. Instead of investing assets in a lump sum, an investor works his way into a position by slowly buying smaller amounts over time. This spreads the interest rate risk out over several years, providing insulation against changes in market price.

In other words, the investor will be able to buy more stocks or funds when the price is low and less when the price is high – and therefore less attractive.

Other Factors to Consider

Of course, there are many factors that will affect how much you have for retirement, including how much you plan to spend annually. Most advisors suggest you only spend between 3% and 5% of your assets in any given year on your core needs to ensure that you don't deplete your savings if the stock market performs poorly for an extended period of time, inflation heats up again and/or you live longer than you expect.

Much will also depend on just how long you plan to work. Assume you have $10 million and decide to retire at age 55, and your spending rate was 3.4%. All else being equal, you could spend $340,000 a year and not reduce your capital base.

But suppose you wanted "excess capacity" for charities, gifting, an extra home, etc. If you postponed retiring for five additional years, you could gain $120,000 a year in annual spending power, according to Alliance Bernstein. And by waiting until age 65 to retire, you augment your incremental annual spending by an additional $180,000.

Only you can decide which level of spending is appropriate for you, but a good financial advisor can help make sure that you are being prudent in your spending and investing plans.