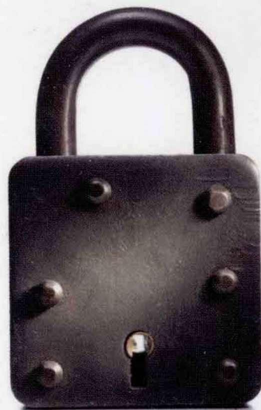
WEALTH MANAGEMENT IN ANY MARKET



Timeless Strategies for Building Financial Security

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Foreword by RICHARD GOLOD

Director of Global Investment Strategies, Van Kampen Investments

Wealth Management in Any Market

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Foreword

Wealth management is a lifelong journey. Like any journey, it helps to know where you want to go and how you want to get there. The route taken will differ for each individual.

It cannot be said often enough: The better and the earlier you plan, the easier it will likely be to reach your financial destination and to secure your future and those of your loved ones. If the journey was a cross-country family vacation, it might be helpful to know the following: what vehicle to use, what roadways to take, and what time to start, rest, or continue, based on the weather forecast, what your average speed will likely be, and what traffic conditions you are likely to face. The same can be said about wealth management. It is equally important to know what vehicle to use and what investments to consider, based on your goals, personal preferences, family dynamics, risk tolerance, and time horizon, as well as possible tax and estate planning ramifications.

As hard as Americans physically work to earn and make money, few people invest the time to develop a wealth management plan that includes a comprehensive financial plan. Such a plan should be in writing and coordinated among a wealth management team that includes an estate planning attorney, a CPA, an insurance agent, a trust officer, and a wealth manager who is also a financial advisor. The team and the plan will allow individuals to have the proper legal framework and the diversified investment vehicles to help achieve one's goals. The financial plan should be comprehensive in nature, aimed at ensuring that all assets are working for the investor in an efficient, risk-adjusted manner. It should be monitored and reviewed on an ongoing basis. The process can seem daunting, considering the myriad of theories on asset allocation, unknown financial outcomes, the complexity of financial vehicles available, and tax and legal structures that tend to change over time. Nobody said it would be easy, but it just got easier.

Dr. Bishara A. Bahbah's book, *Wealth Management in Any Market: Timeless Strategies for Building Financial Security*, successfully navigates individuals through the arduous process of establishing a comprehensive wealth management plan. Investors at all levels—whether they are starting out the long journey of building financial security, are currently

accumulating wealth, or are in the wealth distribution phase of their lives—should benefit tremendously from the comprehensiveness and in-depth research and analysis, backed by facts and figures, found in the book.

Depending on your stage in the wealth life cycle, you will find the book as a whole extremely valuable. Some might find certain chapters more relevant and of exceptional benefit to their particular situations. If retirement planning is on your mind—as it should be—you will find strategies and data that will help you build and achieve retirement security. If you are a professional—a physician, lawyer, or businessperson—historically subject to lawsuits more than most, the chapter on asset protection strategies will provide you with unique insights geared to educate you and help you to protect your hard-earned current and future wealth. Irrespective of your level of wealth, you will find the book informative, easy to read and understand, and quite practical.

I have witnessed the author, Bishara A. Bahbah, over the past ten years develop and implement a holistic approach to financial wealth management that is detailed in this book. I know the motivation for this book came from his personal experience in helping individuals and institutions meet their needs. As a practitioner in the wealth management field with an impressive academic background, Dr. Bahbah is unique among his peer of authors who write about financial and wealth management issues. His insights are not just based on study and research but also emanate from years of being a hands-on wealth advisor. Those who have adopted his approach of comprehensive wealth management have found themselves better served by using his timeless strategies for building financial security.

This book is an invaluable resource on wealth management. It discusses what roads to consider and the many pitfalls to avoid. I know that investors, individuals, and institutions at varying levels of wealth, and irrespective of what stage they are at in the lifelong wealth planning cycle, can greatly benefit from the knowledge and insight exhibited in this must-read book.

Enjoy!

Richard Golod
Director of Global Investment Strategies
Van Kampen Investments

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Preface

I could not have written this book at a more tumultuous time in the financial markets since the era of the Great Depression. The bursting of the housing bubble, which affected just about every homeowner in the United States; the subprime lending crisis; the ensuing credit crunch and illiquidity in the financial markets; the unprecedented volatility in commodity prices, especially oil and gold, leading to fears of inflation; the collapse of a major brokerage firm, Bear Stearns Cos., and its fire sale to JP Morgan at $2 a share (subsequently raised to $10 a share, forced by market pressure) from $159 a share a year earlier; the bankruptcy of Lehman Brothers, the absorption of Merrill Lynch by Bank of America; the failure of traditional banks; the Federal Reserve's extraordinary interventions, including the fastest and steepest lowering of prime rates in the span of a few short months, to shore up confidence and provide liquidity—all these developments combined contributed to a tsunami of upheaval in the financial markets not only in the United States but also throughout the world. In fact, 2008 emerged as the year that rewrote the book, at least since the Great Depression, with regard to the structure of the financial industry in the United States for years to come.

Despite all this gloom and doom, history has demonstrated time and time again that following these epic-style crises—whether engendered by the Great Depression, wars (World War II, the Korean War, the Vietnam War, the war in Afghanistan against the Soviets, the first Gulf War, and the U.S. invasion of Iraq), the assassination or resignation of presidents, extraordinary inflation over an extended period of time, the Cold War, and the bursting of the technology bubble—the markets recover. The latest housing, credit, and financial crises will be no exception.

These violent and unsettling episodes, however, force us to reevaluate our views on money and investing, help us learn from the mistakes and the excesses of the past, and force us to emerge stronger and wiser. This is not to say that the future will not hold in store for the next generations other types of "unprecedented" financial crises. Such is the course of history.

Reality, however, paints a different and brighter picture. Admittedly, we have not had time to assess the extent of the damage of the most recent crises. We do know that in the last quarter of 2007, U.S. household wealth fell by $533 billion; nevertheless, U.S. household wealth still stood at a staggering $57,718 billion at the end of 2007.[1] As of the latter part of 2007, about $27,500 billion was in liquid net worth (cash, mutual funds, bond etc.), while household debt stood at about $13,000 billion—not a bad balance sheet. And, up until the recent financial crises, liquid net worth has gone up about $700 billion year-over-year.[2]

Notwithstanding all the negative news emanating from the most recent crises, we are living in a financial era characterized by the following:

- An explosion of wealth followed by a sudden and sharp implosion following the financial crisis that began in late 2007
- Concentrated wealth in the hands of a lucky few
- An increased demand for wealth management

Consider the following data from recent studies by CEG Worldwide, Capgemini Consulting, and Merrill Lynch, among other sources:[3]

- The number of U.S. individuals with investable assets of $1 million or more jumped from 2.0 million in 2002 to 3.1 million in 2007 (1 percent of the U.S. population). Some 460 Americans are billionaires—the largest number of billionaires in the world.[4]
- There are 1.1 million families worldwide with a net worth of at least $10 million. It is estimated that, collectively, these families control some $91.7 trillion in assets (2004). By 2008, the number of these families was expected to increase to 1.9 million—a jump of 74 percent—while cumulative wealth is expected to increase to $154.4 trillion. However, no one is able to assess or numerically measure, at this point, the devastating effects of the turmoil in the financial markets which began in last quarter of 2007.
- The world's 1,100 richest people have almost twice the assets of the poorest 2.5 billion. The United States is still home to the world's truly rich.[5]
- One percent of Americans own 50 percent of U.S. household wealth.[6]
- 1.2 million U.S. households have a net worth of at least $5 million, not counting the family's primary residence. There are approximately 110 million households in the United States.[7]
- There are approximately 916,000 families worth $20 million or more, commanding $112.6 trillion—these are the exceptionally wealthy.[8]

CEG Worldwide divides affluent individuals into four levels:

1. The **mass affluent** with investable assets between $100,000 and $1.0 million
2. The **affluent** with investable assets between $1 million and $5 million
3. The **super affluent** with investable assets between $5 million and $25 million
4. The **ultra affluent** with investable assets of more than $25 million[9]

The largest number of affluent individuals are those whose ages range from 55 to 65 (44.5 percent). Those under 55 represent 31.0 percent, while 65 or older represent 24.5 percent.[10] Among the affluent, 67.8 percent are males, while 32.2 percent are females.[11]

Do not quit your job or hope for a lottery ticket to become wealthy. The main source of wealth among affluent individuals is:

- Their jobs (44.9 percent)
- Their retirement account rollovers (16.4 percent), clearly job-related as well
- Equity in privately held corporations (21.3 percent)
- Inheritance (9.4 percent)
- The sale of a company (8.1 percent)[12]

Do investors want to work with financial advisors? A vast majority (90.2 percent) of affluent individuals want to work with financial advisors.[13] 42.1 percent have one advisor, 43.7 percent have two advisors, and 14.2 percent have three or more advisors. The tendency is that those with more assets want to deal with more than one advisor[14]—an issue and a concern addressed in Chapter 10 of the book.[15]

Only 13 percent of affluent clients leave their advisors because of the poor performance of their portfolios, while 87 percent state as the main reason for switching advisors is what they perceive as the poor service relationship.[16]

The affluent individual is concerned about three major issues:

1. Taking care of his/her heirs
2. Having enough medical insurance
3. Having a secure retirement[17]

Investors want to deal with wealth managers. The increasing complexity of the evolving financial systems, which extend beyond providing investment advice, is leading clients, people just like you, to prefer the wealth

management approach to deal with their financial and other wealth-related issues. A study by CEG's Russ Alan Prince of "middle-class millionaires," those between $500,000 and $5.0 million in liquid assets, has revealed that 77.1 percent prefer working with wealth managers, compared to 18.8 percent that prefer working with a financial advisor or planner, and a mere 4.1 percent that prefer an investment advisor or planner.[18] The more assets individuals have, the more they prefer to work with wealth managers.

As the research in this book reveals, wealth management is complex and entails dealing not only with the ingredients of a successful investment strategy. Wealth management deals with estate planning issues, with learning to save and manage debt, utilizing insurance to mitigate potential liabilities, saving for a comfortable retirement, maximizing the use of gifting, tax planning, and tax-saving strategies, learning how to protect your assets, and selecting a competent wealth management team.

These complex issues are viewed by the wealthy and the not-so-wealthy individuals as too specialized to be managed by one expert. You need a wealth management team, led by an experienced wealth manager who understands these issues, works with tax, trust, and estate planning experts, but is capable, at the same time, of managing and acting as the quarterback of the entire wealth management team and process.

Even though 46.3 percent of advisors identified themselves as wealth managers while others identified themselves according to their investment orientation—financial advisor, investment advisor, financial planner—CEG Worldwide found that only 6.6 percent of advisors are actually wealth managers, while the remaining 93.4 percent were investment-oriented advisors.[19]

What do affluent individuals want from their wealth management team? They want help and guidance with the following:

- Asset allocation, 56.7 percent
- Financial and estate planning, 41.2 percent
- Tax planning, 23.5 percent
- Managing their managers, 1.5 percent want a manager of managers
- Protecting their wealth, 1.0 percent[20]

The twenty-first century has ushered in a new and unchartered era in the investment and wealth management world. We now live in a more complex world, thanks largely to the leaps in advancement in technology; an interconnected global financial, political, and economic system; more complex legal and financial systems; the advancement in science that has extended our life expectancy by decades beyond what it used to be less than 100 years ago, which, in turn, has forced us to either save more to pay for our longer years in retirement or work many years beyond the normal

retirement age; and the spiraling cost of health care, which we need more of as we age and live longer. All these and other factors are forcing us to take a new look at how we manage not only our finances, but also our overall wealth being.

This book is a humble attempt to help you, the reader, to better manage your life and future financial security through the prism of wealth management. You do not have to be wealthy or affluent to benefit from learning about the basic principles of wealth management. Wealth, measured by the amount of money that you currently have, is deceptive and misleading. You need to know the basics of wealth management, because if you are a typical American, you continually strive to improve yourself, and the lives of your children and your grandchildren. And, living in this great land of opportunity, wealth is awaiting anyone who works hard and is determined to succeed.

Prepare yourself. Learn. And, enjoy reading this book and using it as a reference or a guide for comprehending the basics of wealth management in the twenty-first century.

Author's Note

The year 2008 has been described as one of the most volatile and challenging years for investors in financial market history. It was a year that also rewrote global financial history. The year was described as the year of the Great Meltdown, the worst year since the Great Depression, the year of panic, the year of terror on Wall Street, and a year of unprecedented calamities in the history of the financial markets. All these descriptions were not without justifiable reasons. Consider the following events and statistics:

- As of 9 October 2008, the Dow Jones Industrials was down 36.29 percent; the S&P 500 was down 39.10 percent, and the NASDAQ was down 37.81 percent since the beginning of the year. By comparison, the MSCI EAFE Index (representing developed countries outside of the United States) was down 41.37 percent while MSCI EMF Index (emerging markets) was down 50.31 percent.[1]
- The week of October 6 was described as the worst week for U.S. stocks since the Great Depression ended. The Dow Jones was down 18.15 percent and the S&P 500 was down 18.19 percent in the span of five business days. By the end of that week, the S&P 500 was down 42.5 percent from all its all-time closing high, making it the third worst bear market of the last half century.[2]
- The Chicago Board Options Exchange or VIX Index, commonly known as the fear index, rose above 70 for the first time in its history. It had never breached 50 before the week of October 6, 2008. And, Friday, October 10, 2008, the Dow Jones Industrials saw the largest one-day swing in history and traded through a range of 1,040 points.[3]
- Up until 2008, the worst performing decade ever for the S&P 500 was the 1930s and it was down a mere 0.3 percent in total return for the entire 10-year period. The current decade beginning in 2000 and through October 10, 2008, the S&P was down 29 percent in aggregate for the almost 9-year period.[4]
- The U.S. Treasury and the Federal Reserve Bank spearheaded an unprecedented global response to what could prove to be the worst financial crisis in history. Well-known, established financial names such as

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Fannie Mae, Freddie Mac, Lehman Brothers, Merrill Lynch, AIG, Washington Mutual, and others were seemingly placed as footnotes to history as the Federal Reserve virtually doubled its balance sheet within weeks to rescue the financial markets.

- The national debt grew to unprecedented levels in 2008. To illustrate this point, aggregate debt to Gross Domestic Product (GDP) rose from 150 percent in the early 1980s to 350 percent by the end of 2007.[5]
- 12 million households, out of a total of 76 million households nationwide that own their home, have mortgages in excess of what their house is currently worth. Florida and Nevada have been the hardest hit. Home prices in Miami and Las Vegas fell respectively by 28.2 and 29.9 percent on an annual basis as of July 2008.[6]
- It is estimated that as of beginning of October 2008, Americans lost an estimated $2,000 billion in their defined benefit 401(k) pensions over the previous 15 months.[7]
- For those who depend on stock dividends to supplement their income, 2008 saw a 557 percent year-over-year increase in companies cutting their dividend in the third quarter. Analysts estimate the total cuts cost investors $22.5 billion.[8]

No wonder that a whopping 53 percent of respondents over age 60 stated that the economic conditions of 2008 were the worst they had experienced. The survey was even taken before the chaotic events of late September/early October of 2008.[9]

Even though the reasons behind the collapse of the financial markets will undoubtedly be the subject of books and journal articles in years to come, JP Morgan Asset Management aptly described the genesis of the crisis as having precipitated by the lack of credit. "Credit is like the oxygen for the economy," because whether an individual needs to buy a car or home, a small business needs to expand to a second location, or a large corporation needs to build a factory, most of these acquisitions are financed through borrowing, not cash.[10] The lack of trust and confidence in lending markets chocked off the ability of consumers and businesses to finance such projects, thus posing a serious hazard to the economy and precipitating in the near-collapse of the financial markets.

The good news is that unlike the era of the Great Depression, the government, represented by the Federal Reserve and the U.S. Treasury, and the U.S. Congress which controls spending in the United States, moved with full force, albeit, with incremental and sometimes hesitating steps. The $700 billion Troubled Asset Relief Program (TARP) was approved by Congress in an attempt to establish liquidity, bail out banks, and buy illiquid mortgage-related securities which, along with the collapse of the housing market and the subprime crisis, led to the financial crisis of 2008. The Federal Reserve was extraordinarily innovative in expanding its balance sheet, lending to

both depository and non-depository institutions through its discount window, purchasing commercial paper and accepting a variety of collateral over a variety of time periods for these loans. President George W. Bush stated that his administration was taking "unprecedented and aggressive" steps to address the financial crisis.[11] He said that the U.S. government would purchase equity in financial institutions, guarantee new bank debt, and expand insurance for non-interest-bearing accounts along with increasing substantially the federal insurance on bank deposits. These and other actions by the government, the President declared, "are not intended to take over the free market, but to preserve it."[12]

Given these extraordinary steps, the market is bound to form a base from the October lows. As Pete Seeley, a respected economist with MSIM, noted, "There is a genuine note of hope and optimism ... Equities are entitled to rally over the next several months. But investors should not get complacent."[13] John Authers of the *Financial Times* described the "U.S. Treasury's move to buy stakes in the biggest U.S. banks as ending the risk of a general banking collapse."[14] As a result, the cost of insuring against default by the largest U.S. banks was roughly cut in half in a matter of days.

What all this means to the investor is a wake-up call, a reality check and a need to focus on the long term. History has shown that fluctuations are part of the market cycle and that long-term investment plans should not be derailed by market fluctuations, even violent ones as we have seen in 2008. Between 1937 and through 2007, the S&P 500 Index, an indicator of the broader U.S. market, delivered an average return of 10.7 percent. The Index experienced 53 positive years (13 of those delivered annual returns ranging from 30.34 percent to 52.27 percent) compared with 28 negative years (only three of those exceeded 22.10 percent in negative returns).[15] Yes, you might discover in down times that your risk tolerance is in reality much lower than you had assumed. Reviewing your allocations by possibly lowering your equity exposure and not succumbing is the way to go. Market timing is dangerous and could derail your long-term growth plans. Selling at the bottom of the markets and parking your investments in cash is a huge mistake. It will rob you of the opportunity to recover when the markets recover.

Although investing is only one component of wealth management, it is nevertheless a critical component. The chapter on investing will provide you with time-proven strategies on how to invest keeping in mind that no one allocation or formula works for everyone. Consult your wealth advisor, conduct a review, and learn from history where after each downturn or recession, no matter how severe, the markets have always recovered.

Wealth management is not only about investing. It is multifaceted and a critical component of your overall wealth being. Use the book as an informational guide to help you build a secure and stable future for yourself and your loved ones.

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I could not have written this book without the support of innumerable number of people and institutions.

I begin with acknowledging the role of those academic institutions that have invested in my education. The work ethic that I developed at LaSalle High School in Jerusalem's Old City laid the foundation for my future and advanced learning. I was the recipient of a presidential scholarship at Brigham Young University, where I earned my bachelor's degree and was fortunate to have received a full scholarship at Harvard University, where I earned both my master's and PhD degrees.

My investment and financial training took me through prestigious institutions such as the Wharton School of Business, the Business School at the University of Chicago, the American College, and Canon Financial.

The people who deserve my gratitude are those who have helped me learn the business and the concepts, edit segments of this book, and make its writing and publication possible. Among those people of note are: Steve Moore, who was the first to help me understand the need for wealth management and taught me the value and multifaceted uses of insurance; estate-planning attorney John C. Vryhof, who meticulously edited the chapter on asset protection strategies; Ann Couch, a respected CPA, who patiently answered my frequent queries regarding tax and accounting issues; John Sabino, who reviewed the chapters on estate planning and retirement; Dr. Mark Zener, a prominent trust consultant, whose many presentations that I attended helped me understand the complex concepts of wealth management; Mag Black, Bob Magel, Robert Gaines, Kenneth LaFleur, John Kazanjian, Jeff Welday, Henry Kaplan, Anthony Davidow, John Jaber, James Cadet, Esther Grantham, and Sharon Lilikes, who either encouraged me as I was writing this book or who ultimately facilitated its approval for publication by the prestigious Wall Street firm for whom I work; Peter J. Tanous, a prolific author himself, who read the first chapter I wrote and urged me to finish the manuscript and get it published; Theron Raines, someone whom I have never met in person who became my agent and worked hard to secure a prestigious publisher for the manuscript; my associate Adam Sowa and my assistant Rebecca Pekala, who understood my bizarre schedule and

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CHAPTER 1

Wealth Management

The Cornerstone of Your Future Security

People often refer interchangeably to investing and wealth management as though they are one and the same. Investing and wealth management are not the same. Investing is only one component, albeit a very important one, of wealth management. According to a study by CEG Worldwide and sponsored by Dow Jones & Co., wealth management is defined as a "consultative process that engenders close client relationships and provides customized solutions tailored to individual needs."[1] Based on the report's criteria, only 6.6 percent of surveyed advisors fit into the wealth management mold, while the rest are investment generalists. Wealth advisors have fewer clients—an average of 101—compared to 269 for the generalists, but their average assets under management are almost twice the assets managed by the generalists. Wealth managers tend to specialize in a particular type of a client; implement a formal review process with prospective clients; provide formal action plans; generate greater number of client referrals; and outsource a much larger percentage of their money management business.[2]

In this chapter, we will identify the 15 most common components of wealth management; discuss the composition of your wealth management team; and concentrate on helping you set your goals and objectives, since all plans have to begin by identifying the needs and charting a course of action to reach your desired objectives.

The Components of a Wealth Management Plan

Wealth management is a comprehensive and disciplined approach geared to meeting your financial and other related wealth-planning needs. The goal of wealth management is to maximize your financial well being through proper planning and by adhering to sound investment principles. It is intended to benefit you, your family, the people you care for, and the causes you believe

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