



## THE RIGHT PORTFOLIO AT THE RIGHT PRICE

### INTRODUCTION

Here's a quiz: Let's say that you are a successful professional with your own thriving business, you're married to another successful professional, and you have children and a large, lovely home. After years of effort, your business is beginning to generate significant income. What should you do to maximize the benefit of the value that you are able to take out of your business?

Do you: a) keep cash in a bank account or buy low-interest CDs because you don't trust the market; b) look around and talk with friends, read the investment magazines and newspapers, select a few solid companies that you know fairly well, and buy these to watch them go up; c) pick some stocks or mutual funds that have done well; or d) recognizing the importance of diversification, do all of the above?

While these approaches share a certain do-it-yourself appeal, none of them would be likely to produce a portfolio that provides the greatest potential for long-term growth, relative to the risk you take. Each has hidden costs, invisible risks and lost opportunities that *will* affect your net worth. If you're too conservative, inflation becomes an important risk. If you concentrate on stocks in a single industry, you are at the mercy of the fortunes of that industry. If you pick stocks or funds based on recent performance, you'll load up on one type of investment, missing important opportunities to diversify. How these factors affect you depends on exactly what you do — but the long-term impact on your portfolio is sure to be significant.

Think about your business: you don't trust its management to an amateur, or gamble and just hope for the best. You hire the best professional manager you can find. Your wealth needs the same care to thrive and grow. So let's say that you've located a traditional advisor at a large bank or brokerage firm. This advisor has created an investor profile for you, determined an asset allocation based on that profile, and proposed that you buy a collection of investment products — mutual funds or separately managed accounts, bank and insurance products, and possibly even hedge funds. This basket of products will fulfill, more or less, the target asset allocation. Is this the best portfolio you can find in today's market? Is it the best cost? It may surprise you, but for a discerning investor, the answer is no.

## **THE TRADITIONAL APPROACH FALLS SHORT**

The traditional advisor's approach does not give you the best portfolio *or* the best price. It gives you a package of off-the-shelf investment products, matched to (at best) a basic outline of your characteristics as an investor. To invest in all these products, you may end up fragmenting your portfolio across a large number of accounts. You'll pay your advisor a fee to choose these products and keep track of them all, and then pay the managers of the products. Yet despite the elaborate machinery and the layers of fees, this portfolio fails to address the complex needs that distinguish you from other individual investors. Individual investors need more — more sophistication, more granularity and more value through less layering and lower costs. They need a coherent program of portfolio planning, design, and management that matches their specific and often idiosyncratic requirements. Individuals need an investment plan that accommodates their income patterns and cash requirements. They need a flexible, unified portfolio management discipline that enables them to take full advantage of the features of a diverse array of tax and estate plans, yet can accomplish all this without excessive layering of fees and without creating a disorderly profusion of accounts. Unfortunately, most traditional investment advisors do not have the wherewithal to provide this level of service to individuals at any price.

## **THE TRADITIONAL APPROACH CANNOT MEET THE COMPLEX NEEDS OF INDIVIDUALS AND FAMILIES**

Individual investors often have complex, idiosyncratic needs that make creating the best investment portfolio for them a remarkably sophisticated exercise. One investor has restricted holdings or a mass of options with a large tax overhang. Another has an emotional attachment to a stock inherited from a parent. In another household, both spouses are co-founders of a public company, with significant value but marginal liquidity. Investors also often have less obvious risks in their lives, such as home ownership in a region dominated by a particular industry, where the value of their home may even be correlated with value of their business. Some, confident in their knowledge of the sector in which they work, invest heavily in it, which only compounds their risk. Others wish to apply social or environmental screens to their investments. All of these investors need portfolios designed to take their specific circumstances and concerns into account, with implementation plans contoured to correspond to their individual needs and constraints. This is more than the traditional approach can achieve.

Taxes add still more complexity. Managers of tax-exempt, institutional portfolios have the luxury of choosing and adjusting positions without regard to the tax impact of dividends and capital gains, and most institutionally oriented investment firms carry this approach over to their individual clients. Mutual funds cannot possibly take the individual needs of their investors into account. But each individual's tax position is unique, so taxes require individual treatment. The tax impact of a trading decision can vary widely depending on the household's tax position.

Taxes cannot be an afterthought, but should be a factor woven into the design and execution of an individual's investment plan.

Fully integrating individual requirements and tax management into an investor's portfolio scheme requires a conceptual shift away from management by account to management of the entire portfolio. Individuals often have complex account structures. Many families have IRAs, 401(k)'s, trusts, individual and joint accounts, and other types of accounts. These accounts usually serve tax and estate planning, rather than investment, purposes. Sound investment planning for individuals creates a single, overarching portfolio design that includes all these different accounts. Because of their differing tax characteristics, different types of registrations should logically often hold different types of assets. This asset location decision should occur before — or better still, independently of — any portfolio management decisions. It permits a more optimal distribution of the assets among the various tax and estate structures to take advantage of their particular characteristics. Many advisors simply replicate the target allocation in each tax segment of the portfolio, failing to capitalize on key opportunities to shelter income and manage capital gains taxes. This lack of awareness often results in unnecessarily cumbersome account structures, higher costs, and fewer tax efficiencies realized on behalf of the investor.

The traditional portfolio plan falls far short both because it is not complete in what it provides, and because it is too expensive relative to the value it delivers. Because of its product orientation (the advisor sells the individual an assortment of products, but does not manage those investments or have any ability to determine how they are traded), it avoids dealing in detail with an individual household's idiosyncratic investment requirements or tax situation. And where an advisor charges a fee to allocate clients' assets among externally managed products (whether they are separately managed accounts or mutual funds), the structure tends to generate a multiplicity of unconnected accounts, with layers of fees (some visible and some hidden), shared among your firm's advisors, sales agents, brokers, traders, and the firm itself; as well as external funds' sales agents, managers, and firms. Not only does this layering of responsibilities create multiple fees; precisely because the structure is so cumbersome, it also prevents your advisor from delivering a well-coordinated portfolio.

#### **THE RIGHT APPROACH FOR THE RIGHT PRICE**

If the traditional process does not produce the best portfolio, what does the best portfolio planning process look like? Like the traditional approach, the complete portfolio plan begins with an asset allocation target, but it's doesn't stop there. It also includes analyses of all critical, individual factors that influence the risk profile of the overall portfolio. It adds a description of any systematic tilts, details the assignment of assets across accounts, adjusts sector exposures and describes constraints on holdings that will govern the portfolio.

A complete portfolio serves as a clear map by which to manage the entire portfolio. A single manager using suitable quantitative techniques can match the structural requirements of the portfolio plan directly and seamlessly, meet and monitor the individual household's requirements, and give active consideration to the tax impact of every trade. This unified, custom-designed implementation eliminates the need to fragment the portfolio among several products. The result is a better fit, without the duplication of accounts and without the duplication of fees. Traditional management, with its emphasis on picking securities, is simply too rigid to do all this.

## **CONCLUSION**

Individuals and families often face a bewildering set of individual investment issues. Unfortunately, the traditional investment approach practiced by many investment advisors is too rigid in both design and implementation to address the complexities of individuals' portfolio requirements, or to manage the reality that most individual investors' portfolios are subject to taxation. Many individuals would benefit from a highly customized portfolio design, shaping their investments according to their own specific needs and circumstances to reduce risk in some areas and pursue opportunity in others.

Creating a portfolio that truly meets an individual's needs requires adopting a detailed investment plan, which goes beyond asset allocation to include personalized investment requirements that reflect the full range of considerations that should shape the investor's portfolio. This investment plan should also determine the asset location best for the investor, parceling out securities by type across accounts in different tax regimes. Only with this integrated plan in place can the process of building and managing the actual portfolio begin.

With a complete portfolio plan in place, an investor is well positioned to take advantage of the power and flexibility of structured portfolio management. A structured approach can conform fully to the individual household's requirements, manage the household's tax exposure, maintain diversification and take full advantage of quantitative investment disciplines. The structured approach permits the direct management of the portfolio to conform to the portfolio plan, eliminating inefficiency in terms of layers of management and numbers of accounts. In the end, a seamless approach, progressing directly from a complete portfolio plan to disciplined, structured portfolio management, can provide investors with a better portfolio at a better cost than would be available using the traditional approach.

-Jonathan Tiemann  
Menlo Park  
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## **ABOUT TIEMANN INVESTMENT ADVISORS, LLC**

This note describes the new gold standard in portfolio management for high net worth individuals and families. The approaches and methods described above address deficiencies in traditional practices intended to match individual investors with standardized, off-the-shelf products. Tiemann Investment Advisors, LLC (TIA) was founded in 2002 by an investment expert to provide high net worth individuals with investment services of the highest caliber, making use of techniques designed specifically for individuals. Traditional firms typically rely on legions of salespeople, resulting in a model of investment advice that is little more than a product sale. Advisors in these firms often have little ability to provide careful, expert attention to the specific holdings, circumstances and taxability issues of the individual.

TIA takes full advantage of the power of structured portfolio management. The firm has developed technology-based methods for managing most routine investment functions, thus releasing a greater amount of expert time for tackling the unique investment challenges of each client's circumstances. The firm's starting point with each client is to understand the individual complexities of their investment situation, from the most sophisticated investment vehicles to the most fundamental emotional constraints. This evaluation leads to a custom portfolio design, which leads seamlessly to implementation through a structured portfolio management approach. By managing most clients' portfolios directly, TIA often simplifies account structures and removes layers of fees. TIA charges a set management fee (less than the expense ratio of many mutual funds) and receives no "under the table" fees or commissions. TIA also works to reduce the costs of trading your account, and regards brokers as counterparties whose interests differ from those of investors. TIA operates to the highest standards of professional and ethical conduct, including complete confidentiality and forthright reporting. We take seriously our role as a fiduciary in the advisory relationship, and do not represent any corporation's securities, hold an inventory of securities, hire securities analysts or tout any investment. TIA currently has over \$50 million under management, and our clients include professionals in finance, entertainment and technology. TIA's founder and president, Jonathan Tiemann, holds a Ph.D in finance from Yale University and has more than two decades of experience in academia, institutional investment management, and high net worth investment management. Dr. Tiemann founded TIA on the belief that you *can* get the right portfolio at the right price.

*Tiemann Investment Advisors, LLC is a registered investment advisor based in Menlo Park, California. More information is available on request to: [information@tiemann.net](mailto:information@tiemann.net) or*

*750 Menlo Avenue, Suite 300  
Menlo Park, California 94025  
650 566-0200*

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