Module 19: Overview of Private Wealth Management

19.a: private client & institutional client investment concerns.

Investment Objectives.

Private clients has a wide range of investment objectives which may not be precisely defined. & can change over time.

Institutional clients are more likely to have clearly defined objectives

Constraints:

1. Time horizon
2. Scale / Size (Private client size is smaller)
3. Taxes (Institutional clients like endowment might get tax exemption)

Other considerations

- Governance Structure
- Implementation Sophistication
- Regulatory Environment
- Investor uniqueness & complexity

MODULE QUIZ 19.1

1. Which of the following statements is *most accurate* with respect to the difference between private and institutional clients?
   A. Private clients are more likely to have clearly defined investment objectives compared to institutional clients.
   B. Private clients are likely to have shorter investment horizons and smaller portfolio sizes compared to institutional clients.
   C. Private clients are likely to have a more formal governance structure and a lower degree of investment sophistication compared to institutional clients.

2. Which of the following investments is *most likely* to be appropriate for a private client with a short investment horizon and high liquidity needs?
   A. Global bonds.
   B. Hedge funds.
   C. Private equity.

1. B
2. C A Bond provides regular income, meeting liquidity needs

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19.2: Info needed when advising private clients

1. Personal info
2. Financial info
3. Tax consideration
   - income tax
   - Wealth-based tax
   - consumption tax

   Tax effects must be considered:
   - Tax avoidance
   - Tax reduction
   - Tax deferral

4. Other client info.

MODULE QUIZ 19.2

1. Ray McPherson, CFA, is meeting with a new private client, Henrietta Gove, to plan her investment strategy. McPherson has already established that Gove is 40 years old and works in internal audit for a publicly listed company. Gove mentioned several financial objectives during their last conversation and stated that she prefers low investment volatility. Gove's income more than adequately covers her expenses, and she would like to understand how her portfolio can fund a comfortable retirement lifestyle.

   List *five* additional pieces of personal information that McPherson should gather from Gove in order to prepare Gove's IPS.

2. A private wealth manager is educating her client on the importance of tax-efficient strategies. She makes the following three statements:

   Statement 1: I recommend that you change the asset location of your investment in high-coupon corporate bonds from a taxable account to a retirement account that allows tax-free earnings and withdrawals.

   Statement 2: You should reduce your exposure to dividend-paying equities in favor of a more tax-efficient asset class.

   Statement 3: If required, you should use an account that allows tax-free earnings but requires taxes to be paid on withdrawals.

   Identify the tax strategy (tax avoidance, tax deferral, or tax reduction) associated with each statement and give *one* reason for each answer.

3. Joan Cheong, CFA, just completed a portfolio review meeting with one of her private clients. Which of the following statements describes a soft skill that Cheong utilized in managing her client's portfolio?
   A. Cheong rebalanced her client's portfolio in accordance with the guidelines in her client's IPS.
   B. Cheong updated capital market expectations for the asset classes that are suitable for her client's portfolio.
   C. Cheong explained her client's portfolio performance in easy-to-understand terms and in her client's regional dialect.

1. - Family circumstances.
   - Proof of client identifications.
   - Future career aspirations.
   - Retirement plans.
   - Sources of wealth
   - Specific return or investment objectives
   - Unique investment preference
   - Further discussion of risk tolerance

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2. Statement 1: Avoidance
Statement 2: Reduction
Statement 3: Deferral

3. C

19.3: Formulating Client goals & Evaluating Risk Tolerance

Planned Goals: reasonably estimated within a specified time horizon (e.g. retirement goals, specific purchases)

Unplanned Goals: unexpected financial expenditures (e.g. unexpected medical expenses not covered by insurance)

Private Wealth Manager's role in formulating client goals:
- Quantifying goals.
- Prioritizing goals
- Changing goals

EXAMPLE: Formulating client goals

Bonnie DuBois, a 60-year-old U.S. citizen, has just retired after a 35-year career in the fashion industry. Through a modest lifestyle, disciplined saving, and the help of a private wealth manager, she has accumulated a $2,000,000 diversified portfolio.

DuBois resides in a house that has been paid off for several years. She estimates she will need $60,000 per year, with annual increases for inflation, to fund her lifestyle in retirement. One of the benefits of DuBois's past employment is comprehensive health insurance in retirement, but she is concerned that she might need long-term care in the future.

In a recent conversation with her wealth manager, she mentions her desire to help support her son Barry, his wife Betty, and their three children (ages 14, 12, and 10). Barry's and Betty's combined salaries barely meet their living expenses currently as they hold relatively junior roles in their respective employment. DuBois expects to provide them with $30,000 per year for the next five years and states that supporting her son and his family is the most important priority for her because of its proximity timewise.

She also wishes to purchase a vacation property in five years, although she is unsure how she will fund the purchase. She has informed Barry and her wealth manager that, at her death, her estate will be gifted to a local museum.

1. Identify DuBois's planned and unplanned goals.
2. Discuss how DuBois's private wealth manager can assist her with quantifying and prioritizing her financial goals.

1. Planned Goals: 1. funding her lifestyle in retirement
2. supporting her son & his family for the next 5 yrs.
3. Purchase a vacation property in caribbean
4. Gifting her estate to local museum @ her death.

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Unplanned Goals:

- long-term healthcare costs & property repairs

2.

19.e:

Risk tolerance : Client's willingness to take risk.

Risk capacity : Client's ability to take risk.

The ability to bear risk is decreased by:

- shorter time horizon (not longer !!)
- large critical goal (in relation to size of port)
- high liquidity needs
- situations where port is sole source of support

Risk perception : subjective measure of investment risk (e.g. whether a private client think of loss as absolute or percentage term)

MODULE QUIZ 19.3

1. Vivian Collins is a client of ESP Financial Advisors. She presents her personal circumstances as follows:
   - Collins is 45 years old, divorced, and has a daughter, Daija, aged 15 years.
   - Collins has worked at her current job with the government for the last 23 years and assumes that she will remain there until retirement in 20 years when she will collect her pension. Currently, her employment income comfortably covers her living expenses.
   - She wants to be able to send Daija to the college of her choice and states that this is her highest priority goal as it will happen in the next 3–6 years.
   - Collins expects her daughter to eventually marry and have children, and she would love to be able to leave something to her future grandchildren.
   - Collins expects her pension to cover most of her retirement expenses and thinks she will need $20,000 per year from her modest investment portfolio to fund her retirement lifestyle.

   Identify the issues relating to Collins's goal quantification and goal prioritization.
2. As a client of ESP Financial Advisors, Vivian Collins, age 45, expects to retire in 20 years. Her financial advisor is evaluating her risk tolerance level associated with each of the following financial goals:

   Retirement: Collins views retirement as a long-term goal and is prepared to accept a 10%–15% drop in expected retirement spending. However, she is concerned that she might face unexpected health-related expenses in retirement.

   College fees: Collins wants to be able to pay for her daughter's college education in the next 3–6 years. Currently, this is her highest priority goal.

   Gifting: Collins would like to leave a gift to her grandchildren at her death.

   Describe Collins's risk tolerance level associated with each of her financial goals as either *lower* or *higher*, and **justify** each answer.

1. Goal qualification : need to qualify daugther's college expense & amt she would like to gift to her grandchildren

Goal prioritization : need to prioritize her finance goals & reevoluate her goals if the financial support of her daughter's college education and/or the desire to leave her grandchildren a gift adversely impact her ability to fund her lifestyle.

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2. high risk tolerance associated w/ retirement, b/c it's a long term goal (retiring in 10-15 yrs) &
low risk tolerance associated w/ college fees goal b/c it's a near-term & her highest-priority goal
high risk tolerance associated w/ leaving a gift to her grandchildren @ her death b/c of the long-term nature of the goal.

Module 19.4: Cap Sufficiency Analysis

Cap Sufficiency Analysis enable wealth managers to determine the likelihood of their clients being able to meet their financial objectives

Deterministic Forecasting

A traditional, deterministic, linear return analysis assumes the client portfolio will achieve a single compound annual growth rate a/c the client's investment horizon. Inputs of the forecast include:
- current value of investment portfolio
- investment horizon
- annual return assumption
- CF in/out of the portfolio over investment horizon
- Impact of taxes, inflation

Deterministic Forecasting is easy to understand & implement but not representative of the market volatility.

Monte Carlo Simulation

EXAMPLE: Interpreting Monte Carlo simulation results

A private wealth manager has performed a Monte Carlo simulation for a client who wants to gift $1,000,000 to a local art museum in 20 years. The results of the simulation for specific time intervals and percentiles are shown in Figure 19.2.

Figure 19.2: Monte Carlo Simulation Results for Client's Portfolio (Inflation Adjusted)

Percentile	Year 15 Portfolio Value	Year 20 Portfolio Value	Year 25 Portfolio Value
25th	$890,931	$1,339,655	$1,977,523
50th	$779,809	$1,103,982	$1,592,294
75th	$669,433	$883,247	$1,204,454
Successful trials	8%	61%	89%

From Figure 19.2, the wealth manager can conclude that 61% of trials met the client's financial objective after 20 years (i.e., the probability of success is 61%). Over the same time period, 50% of trials achieved a portfolio value in excess of $1,103,982 (the portfolio value at the 50th percentile), while 25% of trials achieved a portfolio value in excess of $1,339,655 (the portfolio value at the 25th percentile).

Wealth managers tend to use a *75%–90% probability of success* as a rule of thumb when advising private clients. If the probability of success is considered unacceptably low, a wealth manager could propose one or more of the following courses of action:

- Increase contributions over the investment horizon.
- Reduce the financial goal amount.
- Increase the time horizon for the financial goal.
- Pursue an investment strategy with higher expected returns while remaining within the client's risk tolerance.

While capital sufficiency analysis is a useful tool in financial planning, wealth managers should be careful not to pursue an investment strategy based only on its conclusions (it may not always be feasible to extend the time horizon for a financial goal in order to increase the probability of success).

MODULE QUIZ 19.4

1. A private wealth manager has performed a Monte Carlo simulation for a client who wants to make a $2 million charitable donation in 25 years. The results of the simulation for the charitable donation (adjusted for inflation) are shown in the following table.

Percentile	Year 20 Portfolio Value	Year 25 Portfolio Value	Year 30 Portfolio Value
25th	$1,933,318	$2,907,062	$4,291,225
50th	$1,692,188	$2,495,637	$3,455,269
75th	$1,452,663	$2,116,646	$2,613,665
95th	$1,308,705	$1,751,233	$2,196,357

The probability that the client's goal will be met is *closest* to:

A. 25%.
B. 50%.
C. 75%.

1. C.

19.h : Principles of Retirement planning

Analysis of Retirement Goals :

Mortality tables : Shows life expectancy for an individual @ different ages & enables a private wealth manager to determine the probability that a client will survive to a given age. These probabilities can be used to weight the expected annual CF of a client in retirement. to estimate the PV of the client's retirement spending needs.

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The client is faced with longevity risk (i.e. the risk of outliving one's financial resources) since the actual probability of a given private client reaching a certain age might be understated.

Annuities: PV of a client's retirement spending needs can be determined by pricing an annuity.

if a private client's retirement spending needs are expected to be relatively stable over the client's life expectancy, a life annuity can be used to reduce longevity risk.

Behavioral Considerations when advising retirees

managers need to consider the following behavioral biases:

- Increased loss aversion
- Consumption gaps.
- The annuity puzzle
- Lack of self-control (meet their spending needs from investment income rather than liquidating securities)

MODULE QUIZ 19.5

1. When analyzing a client's retirement goals, a private wealth manager considers the probability that the client will live to a certain age and then predicts the client's retirement spending requirements using the probability that the client will still be living in a given year. When combined with the client's expected annual cash flows in retirement, this approach enables the wealth manager to estimate the present value of the client's retirement spending requirements. The approach that the wealth manager is *most likely* using is:
   A. the annuity method.
   B. Monte Carlo simulation.
   C. mortality tables.
2. The behavioral bias exhibited by retirees who prefer to meet their spending needs from investment income rather than by liquidating securities in their investment portfolio is *most likely* related to:
   A. consumption gaps.
   B. self-control bias.
   C. heightened loss aversion.

1. C
2. C. B Retirees preferring to spend investment income rather than liquidate securities is that retiree considers this a self-control mechanism

196 : IPS

IPS usually covers :
- Client Background & Investment Objectives
- Key Investment Parametres
- Portfolio Asset Allocation
- PM & Implementation
- Duties & Responsibilities of the private wealth manager

Client Background & Investment Objectives

background details obtained from relevant personal, financial & tax info.

For the Exam: Past exam questions have required candidates to specify risk and return objectives when preparing an IPS. In this reading, you are required to prepare investment objectives separately from risk tolerance, which is considered under investment parameters.

EXAMPLE: Preparing client investment objectives

William Elam recently inherited $750,000 in cash from his father's estate and has come to Alan Schneider, CFA, for investment advice. Both William and his wife, Elizabeth, are 30 years old. William is employed as a factory worker and has an annual salary of $50,000. Although he receives total health care coverage for himself and his family, he makes no contributions to his firm's defined benefit pension plan and is not yet vested in any of the company's other retirement benefits. Elizabeth is an early childhood teacher with a salary of $38,000. She has only very recently opened a tax-deferred 403(b) retirement savings account. They have three children, aged eight, five, and three. They have a small savings account, no investments other than Elizabeth's retirement account, and credit card debt of $20,000.

When interviewed, William makes the following statements:

- "With a family of five, our combined salaries just meet our living expenses. It would be safe to assume that both our salaries and expenses will grow only at the rate of inflation."
- "We do not want to use our new wealth to improve our current lifestyle. Instead, we would like to grow the investment portfolio so that we can send our children to college and fund our retirement lifestyle when we stop working in 30 years."
- "We also want to set up a trust fund in the future for our children."

What are the key issues that Schneider should consider when preparing the investment objectives section of William's IPS?

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Purpose of the port:

- pay for his children's college education
- fund the retirement of him & Elizabeth
- set up a trust fund

Since William & Elizabeth earn an income that covers living expenses on an inflation-adjusted basis, distributions will begin when their children commence their college education in approx. 10 years. After paying for their college education, the couple will require distributions from the investment portfolio to set up trust fund.
Schneider should help the Elams quantify & prioritize their multiple investment objectives.

He can use cap sufficiency analysis to determine the likelihood of these competing objectives being met given the size of the investment portfolio.
He should also help them reevaluate & revise their current objectives if these objectives are not supported by cap sufficiency analysis.

Key Investment Parametres
- Risk Tolerance
- Time Horizon
- Investment preferences
- Contraints

For the Exam: Past exam questions have required candidates to analyze a private client's time horizon, liquidity needs, taxes, legal and regulatory considerations, and unique preferences as investment constraints. *In this reading, risk tolerance, time horizon, liquidity preferences, other investment preferences, and constraints are analyzed as investment parameters, while taxes are included as part of the client's financial background information.*

For the most part, you are provided with all the relevant information for a client's investment parameters in the story. A typical question might require you to address all the previously mentioned investment parameters in 10–12 minutes. You should give a brief factual answer for each parameter, supported by relevant facts from the story. If there are no issues to address for a particular parameter, say so in the answer rather than leaving it blank.

Alternatively, a question may only ask you to address specific investment parameters and assign more minutes for each parameter. In this case, only address what is requested and provide more detail in your answer.

Portfolio Asset Allocation

PM & Implementation

Discretionary authority: ability for private wealth manager to make decision w/o seeking permission first.

- Rebalancing
- Tactical changes
- Implementation

Duties & Responsibilities of the private wealth manager

IPS Appendix

MODULE QUIZ 19.6

1. A private wealth manager has gathered the following information from a new client:

Risk tolerance:	Low
Liquidity needs:	$2 million for purchase of holiday apartment in 2 years
Asset class preferences:	No investment in commodities and hedge funds

What information is *most likely* to be included in the *Investment Objectives* section of the client's IPS?

A. Low risk tolerance.
B. $2 million purchase of holiday apartment in 2 years.
C. Investments in commodities and hedge funds have not been approved by client.

2. Which of the following investment considerations is *most likely* to be included as a constraint in a client's IPS?

A. ESG investing.
B. Time horizon.
C. Liquidity preferences.

3. Which of the following items is *most likely* to be included in the *Portfolio Management* section of a client's IPS?

A. Capital market expectations.
B. Modeled portfolio behavior.
C. Portfolio rebalancing methodology.

4. The requirement for a client's investment portfolio to hold a cash reserve and/or constraint on asset class selection because of the need to sell the portfolio relatively quickly is *most likely* to be included in:

A. the *Liquidity Preferences* section of the client's IPS.
B. the *Other Investment Preferences* section of the client's IPS.
C. the *Portfolio Asset Allocation* section of the client's IPS.

5. Vivian Collins is a client of ESP Financial Advisors. She is 45 years old and expects to retire in 20 years. Her financial advisor has determined that Collins has the following financial goals:

Retirement:	Collins views retirement as a long-term goal and is prepared to accept a 10%–15% drop in expected retirement spending. However, she is concerned that she might face unexpected health-related expenses in retirement.
College fees:	Collins wants to be able to pay for her daughter's college education in the next 3–6 years. Currently, this is her highest priority goal.
Gifting:	Collins would like to leave a gift to her grandchildren at her death.

Which of the following descriptions of Collins's investment time horizon is her financial advisor *most likely* to include in her IPS?

A. Collins has a long horizon of 35 years, as she would expect to survive until 80 years old.
B. Collins has multiple time horizons: the college fees goal has a time horizon of 3 years, the retirement goal has a time horizon of 20 years, and the gifting goal has a time horizon of 35 years.
C. Collins has multiple time horizons: the college fees goal has a time horizon exceeding 3 years, the retirement goal has a time horizon exceeding 20 years, and the gifting goal has a time horizon exceeding 35 years.

1. B
2. A
3. C
4. A
5. C

Module 19.7 Portfolio Construction

Traditional Approcches to Port. Construction

steps :

1. Identify asset classes
2. Develop cap mkt. expectations.
3. Determine asset class weights.
4. Assess investment constraints
5. Implement the portfolio

Goal-based investing

Same steps as traditional approach except the manager will set up seperate portfolios for each of the client's goals.

- advantage : easier to specify risk tolerance
- disadvantage : entire portfolio may not be mean-variance efficient.

MODULE QUIZ 19.7

1. Rayyan Patel, CFA, has performed MVO to determine the optimal asset allocation for a client's portfolio, having determined that the maximum portfolio volatility that the client can tolerate is 9%. The MVO portfolio allocation together with three alternative portfolio allocations that Patel is considering are shown in the following table.

Asset Class	Allocation from MVO	Alternative 1 Allocation	Alternative 2 Allocation	Alternative 3 Allocation
Investment-grade bonds	30.5%	35.0%	32.0%	30.0%
High-yield bonds	15.0%	12.0%	10.0%	15.0%
U.S. equities	38.2%	38.0%	30.0%	20.0%
Other (non-U.S.) equities	12.8%	10.0%	20.0%	25.0%
Commodities	3.5%	5.0%	8.0%	10.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Expected return	6.5%	6.1%	6.4%	6.6%
Volatility (in terms of standard deviation)	9.0%	8.7%	8.9%	9.2%

If Patel wants to adjust the portfolio allocation to incorporate his client's preference for non-U.S. equities and alternative investments, which of the following portfolio allocations is he *most likely* to recommend to his client?

A. Alternative 1.
B. Alternative 2.
C. Alternative 3.

1. A B Patel Should recommend Alternative 2 as it correctly in liquidity preference section of an IPS. Other investment preferences might include a concentrated asset position. The Portfolio Asset Allocation section describes the asset allocation approach used for the client's portfolio (e.g. strategic or tactical asset allocation)

19.m : Effective practices in portfolio reporting & review

Portfolio Report for a private client typically includes:
- Performance summary
- Market Commentary
- Portfolio asset mix /allocation
- Detailed performance of asset classes & specific securities
- BM report comparing asset classes & overall portfolio performance to appropriate BMs.
- Transaction details of client's portfolio since inception
- Purchase & sale report
- Impact of currency exposure & FX-rate fluctuations
- Progress towards meeting goals portfolios

Portfolio Reviews.

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19.n: Evaluate the success of an investment program
3 criteria
- Goal Achievement
- Process Consistency
- Portfolio Performance
  can be measured against absolute or relative

MODULE QUIZ 19.8

1. Zach Bond, CFA, provides quarterly portfolio reports to his clients. Each portfolio report contains the following information:
   - Performance summary for the current quarter.
   - Portfolio asset allocation at the end of the quarter, including strategic asset allocation weights or tactical asset class target ranges.
   - Detailed performance of asset classes and individual securities.
   - Benchmark report comparing asset class and overall portfolio performance to appropriate benchmarks.

   List *four* additional items that Bond could provide to improve the quality of the portfolio reports that he prepares for his clients.
2. Christine Tan is preparing to meet Zach Bond, CFA, who has acted as her wealth manager for the last 20 years. Over this period, her portfolio has earned a 6% compound annual return, matching the annual return modeled by Bond in his capital sufficiency analysis of Tan's portfolio 20 years ago. The output of his most recent capital sufficiency analysis indicates that the current portfolio and investment strategy are very likely to meet Tan's future financial objectives. Tan's portfolio return has underperformed its benchmark by 0.3% over this period, while matching the benchmark's volatility. Tan notes that Bond has followed the guidelines laid out in her IPS in relation to ongoing communications, rebalancing methodology, tax strategies, and implementation costs.

   Tan is *most likely* to conclude that her investment program has:

   A. failed because it has not met all three criteria of a successful investment program.
   B. been a success because it has met two out of the three criteria of a successful investment program.
   C. been a success because it has met all three criteria of a successful investment program.

1. following additional items:
   - Market commentary
   - Historical performance
   - Transaction details.
   - Purchase & sales report
   - Impact of currency exposure
   - Progress towards meeting goal. portfolios when using a goal-based investing approach.

2. C A Has met the goal achievement criteria & the process consistency criteria. However, the portfolio performance criteria has not been met.

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19.o: Ethical & Compliance Considerations

Ethical considerations: fiduciary duty, suitability, know your customer requirement, client confidentiality, conflict of interest.
Compliance considerations: vary by jurisdiction.

19.p: Discuss levels of service & range of solutions

Mass Affluent Segment: wide range of management services, larger client-to-wealth-manager ratio & noncustomized port management approach

High Net Worth Segment: smaller client-to-wealth-manager ratio, tailored investment solutions & ports w/ sophisticated strategies & alt. investments.

Ultra High Net Worth Segment: has multigenerational investment horizons, complex tax & estate planning, comprehensive services

Robo-advisors: low management service fee

MODULE QUIZ 19.9

1. Shane Long, CFA, works as a wealth manager for the London branch of a prestigious Swiss private bank. Long is meeting a prospective client, Anna Bradescu, for the first time. In a telephone conversation with Bradescu two days ago, she mentioned that she owns penthouse apartments in Paris, New York, Hong Kong, and Tokyo. At the meeting, she provides Long with her personal calling card that includes an address in one of the most exclusive residential areas of London. Long politely asks Bradescu for her passport and bank account details and enquires about her family circumstances and sources of wealth. The ethical consideration that Long is *most likely* concerned about is:
   A. KYC.
   B. confidentiality.
   C. conflicts of interest.
2. Shane Long, CFA, has just concluded his first meeting with a prospective client, Anna Bradescu. Based on the information that Bradescu has provided, Long believes that Bradescu should be classified as an ultra-high net worth (UHNW) client. Which of the following is *most likely* a characteristic of the UHNW segment?
   A. High client-to-manager ratio.
   B. Complex tax and estate planning considerations.
   C. Greater use of technology in providing wealth management services.
3. The growth of robo-advisors in the wealth management industry is *most likely* driven by:
   A. cost considerations.
   B. the superior ability of robo-advisors to develop sophisticated investment strategies.
   C. the desire to have primarily human interaction for wealth advice coupled with automated portfolio construction, rebalancing, and

1. A /
2. B /
3. A /

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