

Wealth Management Alpha

Long-term Value through Integrated Advice



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The benefits of a tax-efficient, globally diversified investment portfolio are well documented and generally accepted. Most competent advisors understand these benefits and embrace these principles with their clients. For high net worth individuals, however, creating the conditions for long-term financial success requires a much broader and more comprehensive approach. Sound *investment* management is important, but integrated *wealth* management is truly essential in order to make optimal financial decisions.

The term “wealth management” has become ubiquitous in the advisory world. Many financial advisors claim to do wealth management, but very few advisors have the in-house expertise and experience to do it well. At Brighton Jones, we have incorporated the principles of wealth management since our founding over 10 years ago, but for the benefit of our clients and others, we have decided to articulate both the qualitative *and* quantitative components of wealth management in an effort to measure the long-term value that it can add for our clients.

ALPHA

The term ‘alpha’ has come to mean many things. In addition to serving as the first letter of the Greek alphabet, it’s a term used in chemistry, physics, biology, and sociology. As it relates to investments, alpha refers to the excess return beyond what the market provides. If the S&P 500 returns 10%, and Mutual Fund XYZ returns 11%, this 1% excess return is sometimes called ‘alpha.’ Here’s an official definition:

Alpha:

The abnormal, risk-adjusted rate of return on a security or portfolio in excess of what would be predicted by an equilibrium model like the Capital Asset Pricing Model (CAPM).

Although seeking investment alpha is a commendable goal, we wanted to introduce another use for the term ‘alpha’. We believe that the practice of wealth management, of which investment management is an important component, adds a significant amount of quantifiable and qualitative alpha to the long-term success of our clients’ life plans. Here’s a definition:

Wealth Management Alpha (WMA):

WMA is the cumulative economic benefit, both quantitative and qualitative, that Brighton Jones accrues for clients as a direct result of comprehensive and integrated wealth management.

WMA QUANTIFIED

There are numerous qualitative benefits to working with a comprehensive wealth manager (which will be discussed later), but equally important are the measurable, quantifiable benefits. Although each client's situation will vary, we have approximated the benefits below, using our BJ 30-70 Portfolio as a basis for comparison:

	<u>BJ 30-70</u>	<u>Category Avg/Other</u>	<u>Net Benefit</u>
Reduced Internal Expense Ratio:	.38%	1.24%	.86%
Lower Tax-Cost Ratio:	.98%	1.51%	.53%
Disciplined Annual Rebalance:	10.43%	9.89%	.54%
Diversification Benefits	10.43%	10.01%	.42%

Total Net Benefit: 2.35%

Our relationships with institutional money managers give our clients access to institutional share classes that are not always accessible to retail investors. These share classes, along with exchange-traded funds, provide lower internal expenses, the benefit of which accrues to clients' bottom line return.

We have also selected money managers who invest more tax efficiently than the category average. By maximizing after-tax returns, we're able to enhance the long-term rate of return for clients.

A disciplined, systematic approach to rebalancing the portfolio adds significant economic value over time. Through regular rebalancing, we're able to unemotionally pare down positions that have over-performed and add money to positions that have under-performed. The result over time is a lower risk profile for the portfolio and enhanced long-term returns.

Finally, by intelligently diversifying the portfolio amongst numerous asset classes (large, small, value, growth, domestic, international, etc.), long-term returns can be enhanced.

QUALITATIVE BENEFITS

Although the quantitative benefits of professional wealth management offer measurable alpha, there are equally important qualitative benefits that may be more difficult to quantify, but still have a meaningful impact on long-term financial success.

Investment Discipline: An intelligent approach to investing cannot be successful if we don't maintain discipline to the strategy over time. An independent, fee-based wealth manager like Brighton Jones can serve as a barrier of sorts between the investor's emotion and their long-term investment strategy. Although the client will always have the last word, we do our best to keep people focused on the long-term. This objective, rational approach can add significant WMA over time.

Diversification: Academic research has repeatedly shown that effective diversification is as close to a "free lunch" that one can find in the world of investing. By owning asset classes that are not highly correlated over the long-term, portfolio risk can be reduced significantly.

Wealth Management Scorecard: We have built an in-house, proprietary software tool called the Brighton Jones Wealth Management Scorecard (WMS). The WMS is designed to track all aspects of our comprehensive wealth management process, and provides a qualitative score regarding each component of our clients' overall plan.

Tax-Managed Rebalancing: As referenced above, by periodically reviewing the current asset allocation as it compares to our strategic asset allocation, we're able to *tax sensitively* reduce positions that have over-performed and reinvest the excess into asset classes that have under-performed.

Proactive Tax Planning: Virtually every financial transaction involves some consideration for taxation. Whether it's optimizing the value of charitable gifts, harvesting tax losses to offset future capital gains, working through AMT planning issues, or locating tax-inefficient asset classes in qualified accounts, the practice of wealth management is always looking to optimize net after-tax returns. This focus on minimizing taxes can be another significant source of WMA.

Risk Capacity Analysis: Before we can determine the strategic asset allocation for a client, we first need to have a comprehensive understanding of the client's *capacity* for taking risk (which might be different than the client's *tolerance* for taking risk). We assess this by running a Cash Needs Analysis that aims to quantify the liquidity requirements from the portfolio over the next 10-15 years. Only after determining the client's short to intermediate-term cash needs can we design a customized asset allocation that is tailored specifically to the client's risk capacity and risk tolerance.

Vocational Freedom Planning: It's one thing to know how much wealth one has, but to understand the ability for that pool of wealth to provide for one's lifestyle indefinitely (and in many cases provide for the next generation) is entirely another thing. As wealth managers, we understand the dynamic that exists between cash flow planning, vocational freedom planning, wealth transfer objectives, and the overall structure of the portfolio.

Estate Planning: With in-house expertise on a broad range of estate planning tools and techniques, and extensive independent estate planner relationships, clients have access to advice on structuring their estate plan to reduce administrative costs, pass wealth efficiently, and most importantly, minimize estate taxes. Estate planning within the context of wealth management is oftentimes a significant source of WMA.

Risk Management: There are many potentially catastrophic financial risks that could occur at any moment, from property risk and liability risk to disability and premature death risk. Part of effective wealth management involves understanding these risks, deciding which can be self-insured, and deciding which should be transferred to insurance providers. Our in-house expertise paired with outside providers gives clients access to the tools they need to make informed decisions about insurance.

Strategic Philanthropy: For those who desire a substantial philanthropic component to their overall life plan, Brighton Jones can help design and implement charitable giving plans that become effective either while living or at death (or both). Donor-advised funds, private foundations, charitable remainder trusts and charitable lead trusts are some of the many tools at our disposal to help fulfill clients' philanthropic intentions.

Coordination of Outside Experts: An important component of WMA is effective coordination of both in-house and outside experts. Clients may have outside counsel assisting with mortgage refinancing, property and casualty insurance, or the execution of estate planning documents, among many others. Brighton Jones serves as the coordinator and primary point of contact to ensure that all outside advice is integrated and coordinated with the client's broader financial goals and life plan.

Execution: Because we understand and advise on the many components of our clients' financial lives, we recognize the importance of not only establishing a plan, but executing that plan. An estate plan that is drafted but never implemented accomplishes very little. A charitable giving strategy that is proposed but never realized will not advance the worthy causes it endeavors to support. Effective execution is critical, and execution is a powerful and significant component of the value that Wealth Management Alpha™ can bring to a client relationship.

CONCLUSION

The power of Wealth Management Alpha is real, both quantitatively and qualitatively. By working with an objective, independent team of experts, clients should receive incremental economic return that compounds over time and creates measurable value. But perhaps just as importantly, clients gain tremendous peace of mind knowing that their advisor has the expertise to serve as their advocate in all important areas of comprehensive financial planning.

Brighton Jones has been providing this level of integrated advice for nearly ten years, and with a team of JDs, CPAs, CFPs and CFAs, we have the in-house expertise to create meaningful, measurable Wealth Management Alpha for our many valued clients.

Source Data:

Category average obtained via Morningstar database

Tax cost ratio obtained via Morningstar database

Using Zephyr Style Advisor, annual rebalance compared to no rebalancing from 1/1/1980 to 12/31/2008. Numbers referenced refer to annualized returns over this period with annual rebalancing (10.43%) and without (10.01%)

Diversification benefits compares S&P 500 performance to BJ 30-70 portfolio