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# What 80 Years Consulting On Family Assets Have Taught Us About Risk

Can wealth managers give wealthy business families the focussed advice they really need? We think that the answer is a resounding “no”. We think that their focus on liquid assets means they miss the big picture. We certainly don't want to denigrate wealth managers - after all, it is what we used to do - we just want to point out that the tools at their disposal are not designed to give business families what they really need.

And before you ask - yes, we think there is an effective way to do just that. We think that what wealthy families need is a thoughtful approach to wealth that assesses all the risks of their assets, and gives them power - the power to understand where the risks actually lie, which in turns gives them the real conviction they need to make informed strategic decisions about all of their wealth. We call this strategy Termes Risk Focus.

Before we go into the strategy in more detail, it’s important to say where we are coming from. Before we set up The Termes Partnership in 2002 we were the CEO and CIO of a private bank and wealth management company. Between us, we have worked in the wealth management industry for 80 years.

So we know what wealth managers can and can't do. Although they often ask a lot of questions about a client’s assets - and even the right questions - at the end of the day they expect to be given a pot of cash to invest. But the fact is that liquid assets are usually a relatively small part of the overall assets of wealthy entrepreneurial families.

It is true that you sometimes come across a family which has had a liquidity event, and therefore cash to invest. But in most cases the clients we deal with (who have from $100m, up into the billions) are faced with a much more complicated situation.

Usually they run a business or a network of businesses, which can involve several generations of the family. Added to that, they will very often have made direct investments in



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other businesses. Typically they also have real estate holdings - retail, industrial or office space connected with their businesses, and also they will normally need residences in each of the countries where they live or operate or invest.

Generally speaking their liquid assets are residual, so any discussion about those assets is only a part of the more critical or real questions they have to ask themselves.

These real questions start with this one: how do I evaluate my assets? You quickly see that this is a complex question, because it means asking other questions like: how do I compare a 30-year US Treasury bond with a 50% stake in a Japanese cloud computing start-up, or an office building in London? How on earth do I decide which of my investments and asset classes are performing as expected, and which are not?

We might see a situation where somebody invested heavily in real estate at a time when you could get 85% leverage, and they have breached all the covenants. Or they invested in a technology that has since been superseded. These are the kinds of real-world problems that our sorts of families face.

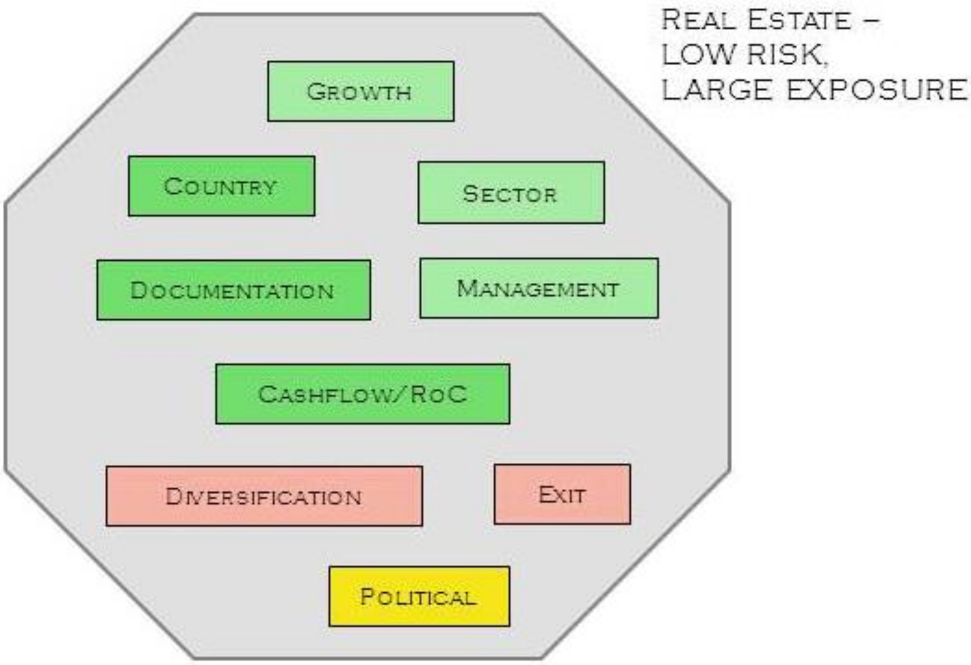
It was while we were working with one family who had exactly these sorts of challenges that we decided we needed to develop a systematic approach that would help them understand the relative opportunities and risks they face. We started to ask ourselves: what would such an approach look like? We realised that it boils down to this: what risk is attached to each of a family's assets?

Now, we recognise that when the wealth management industry talks about risk it talks about volatility, Sharpe ratios, information ratios and so on. We are by no means denigrating that approach. But those things are truly relevant to liquid assets and so they are not too helpful for understanding the uncertainties in a wealthy family's complex and varied portfolio.

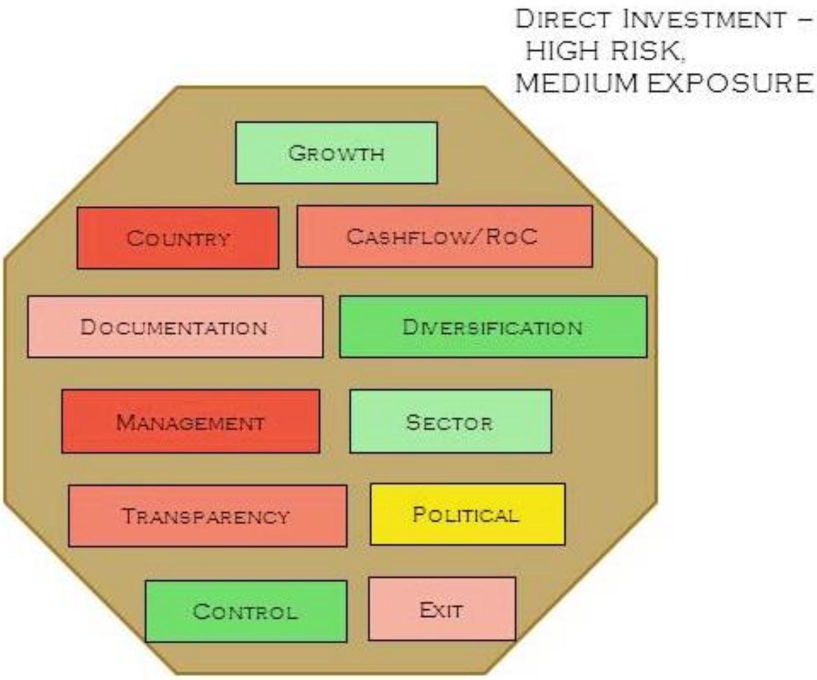
However elegant and intellectually satisfying these mathematical models of risk are, they do not address the needs of a wealthy family. They miss the point. What affects families' assets are the day-to-day things in the real world - the forces that drive taxation or regulation, or free-trade agreements, or executive management effectiveness. If 80% of your wealth is tied up in a brewing business, then understanding Sharpe ratios is not going to get you too far in getting to grips with the risks to your wealth.

And so we took a different approach. We decided to concentrate on things like political, growth, valuation, management, competition and technical risk. Then we asked how we could consistently represent each such risk element visually, and we came up with this scale:

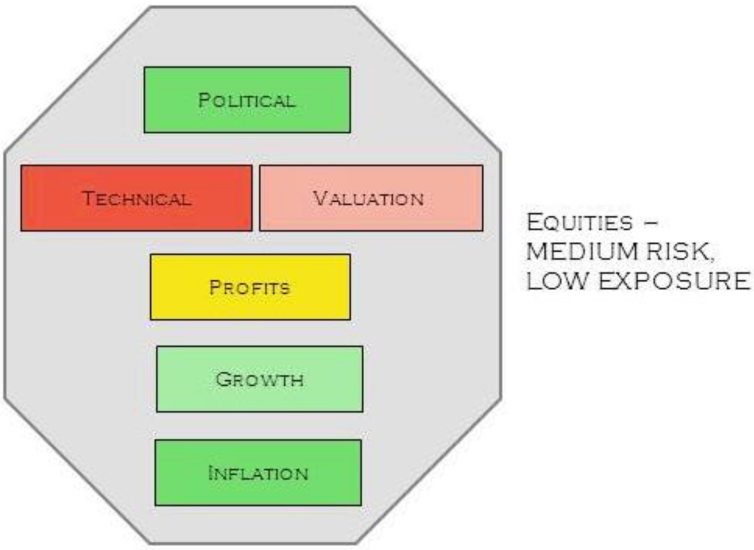

And for each asset class, we applied a value to each risk type. So, for example here is a diagram showing the risk profile of a family's real estate assets:



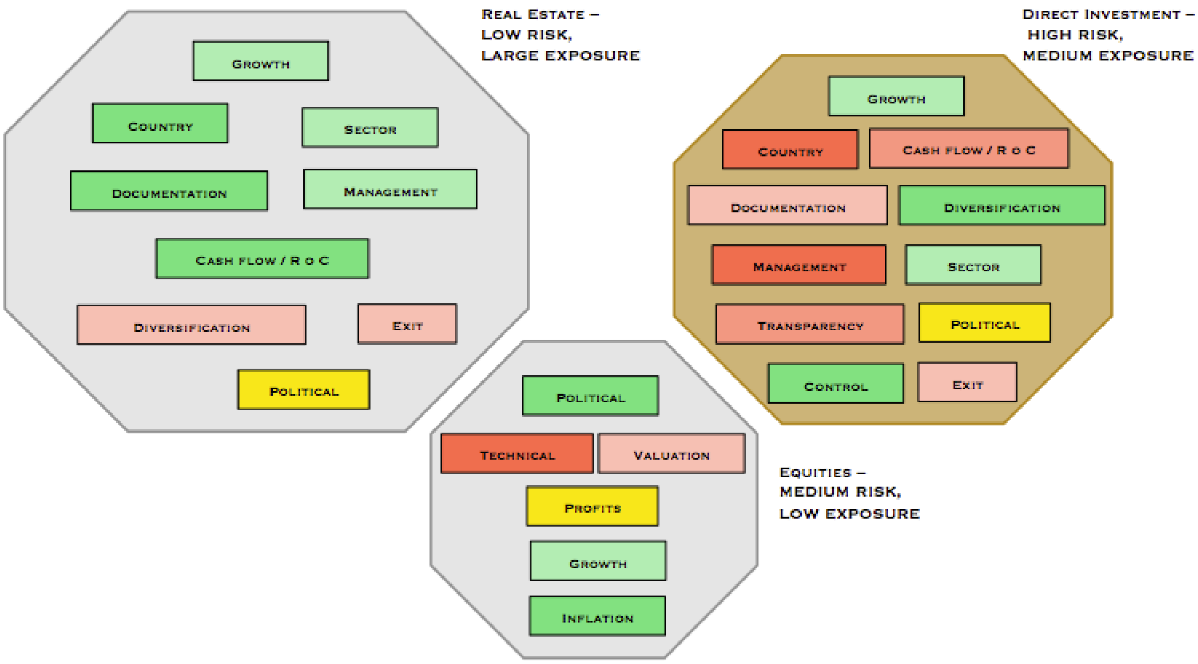

And here is their direct investment risk:



And this is how we assessed their equities portfolio:




We then place these next to each other, with each octagon given a size that corresponds to the amount of money in that asset class:




What you have is an easily accessible representation that allows a family to quickly assess its wealth at this moment in time. That is the first step towards evaluating all the risks that are attached to all their assets, which helps them build a real sense of conviction about whether they are happy with what they have, and what to do next.

We don't pretend that this is a silver bullet. We think of the visualisation as a diagnostic tool. It doesn't tell you what to do next. That depends on the family's values and their perception of what the wealth is for.

And we aren't saying that once you have seen this visualisation you can immediately start shifting assets so that you are happier with your risk profile. To an extent, a family's asset allocation is - what it is. It might have come about by accident, or through decisions that looked good a long time ago. Some might tell you otherwise, but the reality of family wealth is that changing the allocations is not easy, and it can't be done overnight.

That might not be immediately reassuring, but it is the reality for very wealthy families who face hard-to-solve problems when it comes to asset allocation. We think that our model helps them get an effective grip on these challenges. Termes Risk Focus is a sound, tried and tested method that can help all members of any business family, no matter how sophisticated or otherwise, to understand how the land lies.

And that in turn is the first step towards effective wealth preservation. Which is all that anyone can really offer.

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