THE NEW WEALTH MANAGEMENT
THE FINANCIAL ADVISOR’S GUIDE TO MANAGING AND INVESTING CLIENT ASSETS

Harold Evensky, CFP • Stephen M. Horan, CFA • Thomas R. Robinson, CFA
Foreword by Roger Ibbotson
THE NEW WEALTH MANAGEMENT
CFA Institute is the premier association for investment professionals around the world, with over 101,000 members in 134 countries. Since 1963 the organization has developed and administered the renowned Chartered Financial Analyst® Program. With a rich history of leading the investment profession, CFA Institute has set the highest standards in ethics, education, and professional excellence within the global investment community and is the foremost authority on investment profession conduct and practice.

Each book in the CFA Institute Investment Series is geared toward industry practitioners along with graduate-level finance students and covers the most important topics in the industry. The authors of these cutting-edge books are themselves industry professionals and academics and bring their wealth of knowledge and expertise to this series.
THE NEW WEALTH MANAGEMENT


Harold Evensky, CFP
Stephen M. Horan, CFA
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John Wiley & Sons, Inc.
Harold:
To all my wonderful associates at E&K, my two amazing co-authors, and to Deena, who makes it all worthwhile

Stephen:
To Connie and Cayse

Thomas:
To Linda
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We would like to thank the many individuals who played important roles in producing this book.

The CFA Institute Investment Series was developed under the leadership and guidance of Robert R. Johnson, CFA, now senior managing director of CFA Institute. Most of the titles in the series are developed out of the CFA Program curriculum. The CFA Program is a generalist program in investment analysis and portfolio management and emphasizes the highest ethical and professional standards for the investment profession. Over time, the number of CFA Program candidates and CFA Institute members who practice in the private wealth area has increased, calling for additional educational content in this important area. The private wealth content in the CFA Program has increased as well, and this new edition of Harold Evensky’s *Wealth Management* is designed to be a practical guide to implementing many of the concepts found in the CFA Program to private wealth practice.

Christopher Wiese managed the process of acquiring the rights to the earlier edition and guided the manuscript through all stages of production. Tina Sapsara kept the authors on task and edited the manuscripts to a uniform style. We also appreciate Deena Katz adding her expertise for our capstone chapter.
FOREWORD

The New Wealth Management is a new edition of the book Wealth Management, originally written by Harold Evensky. Fourteen years may be a long time to wait between editions, but the new edition is more of an overhaul than a mere update. Two co-authors have also been added to the mix, Stephen Horan and Thomas Robinson; both are accomplished authors in their own right. The current book builds on the strong foundation of the earlier edition while encapsulating the many advances and examples of rethinking that have been accomplished during the intervening time.

CFA Institute has participated in the financial revolution in many of its publications. The New Wealth Management is a part of the CFA Institute Investment Series. Most readers are probably familiar with Stephen Horan, because he has been the manager of the education and private wealth management content for the series. He is a professor, frequently published author, and the editor of the CFA Institute book Private Wealth: Wealth Management in Practice. He brings extensive knowledge and an ability to implement it. Thomas Robinson is managing director of the CFA Institute Education Division. He is also a regularly published author in the fields of accounting and financial planning, as well as an accomplished professor. He has had extensive speaking and consulting experience relating to the issues that come up in this book. CFA Institute is fortunate to have these two very active contributors who are so well-versed in the issues that financial practitioners face.

The combination of the renowned Harold Evensky with CFA Institute support makes for a great book. The writers are not only excellent expositors, but also at the forefront of the field. In this book, they include the latest advancements but still make the book practical for the financial advisor. Advisors need to know not only the latest techniques, but also how to communicate with their clients.

Of course, I am partial to some of the discoveries that I have been involved in. The first edition certainly took the holistic approach to investing, in which each individual client’s specific circumstances are considered and asset allocation portfolios are customized to the client’s needs. But now we have a life-cycle approach to use to determine the appropriate asset allocation for each individual. The approach makes use of a “life balance sheet” that uses human capital theory to consider both the net employment capital and the financial assets as two separate but related sources to fund the lifetime retirement and other expenditure needs.

Now that the life-cycle approach is more developed, we can start with the readily valuable data from a family’s earnings, financial wealth, age, cash flow needs, retirement plans, and so on. These data are then supplemented with information about the nature of the client’s employment, risk questionnaires, and capital market assumptions. The theoretical framework of the life cycle approach was barely available at the time the initial edition was published. Now, we really can take a holistic approach to investing that considers not only the nature of capital markets, but also the client’s circumstances and needs, as well as the personality characteristics that make each client unique.
The importance of the asset allocation decision has also been further clarified in the intervening time between the editions. No longer do we merely think that asset allocation policy explains more than 90 percent of performance. We now know that asset allocation policy usually explains 100 percent of the typical return level because most active management does not actually add any alpha. This is particularly true on average, by definition, because in aggregate all money managed can only sum to a broad market return.

The differences among various manager returns are also only partially explained by asset allocation policy manager differences. Roughly half of the differences in the variation of returns among money managers comes from asset allocation policy differences, whereas the remaining half of the variation of returns among managers is explained by differences in asset allocation timing, security selection, and fees.

Even the time-series variation of returns has three parts: participation in the overall market movement (instead of just holding cash), each portfolio manager’s asset allocation policy differences from the overall market or peer group, and the variation in returns caused by the active management of each portfolio manager’s specific timing, security selection, and fee level. It is the first two parts that explain about 90 percent of the variation in time-series returns of a typical portfolio. But the major part of portfolio variation comes from the market movement, in which most funds participate. Most of us performed well in the bull market of 2009, whereas most of us performed poorly in the bear market of 2008.

I have only touched on a few of the ideas in the book. I hope, though, that this Foreword has whetted your appetite for all the ideas that are inside. These include discussions on risk and taxes, as well as such implementation topics as goal setting, client education, and manager selection. Harold Evensky, Stephen Horan, and Thomas Robinson have done a great service for the financial advisor.

Roger Ibbotson
Chairman and CIO, Zebra Capital Management
Professor in Practice, Yale School of Management
Welcome to *The New Wealth Management*. What you are about to read is a blend of a textbook, an investment process road map, lessons, opinions (lots of opinions), and recommendations based on the experience of practitioners and recent research.

It is easy for a professional, interested in portfolio or asset management, to find and accumulate a library appropriate to the subject (references to the best will be provided throughout this book). There is a continuing stream of books published on the evaluation, selection, and management of individual stocks and bonds. However, for the holistic practitioner managing private wealth and responsible for orchestrating a portfolio of multiple managers, the selection is limited. The only guidance has been to attend professional conferences and network with like-minded professionals. *The New Wealth Management*, first published as *Wealth Management* in 1997, was written to address this need. This edition captures the recent advances and thinking that have evolved since the first edition. And there has been quite a bit.

Perhaps a brief profile of the practitioners envisioned as the audience for this book will assist you in determining if this book is for you.

- Those whose clients are individuals, pensions, or trusts with significant investable assets whose primary goal is to earn reasonable returns for the risk they are prepared to take.
- Those who advise clients on the development and implementation of an investment policy.
- Those who assist clients in the selection of multiple managers, exchange-traded funds (ETFs), or mutual funds.
- Those who monitor and manage multiple asset class investments for client portfolios.
- Those who call themselves financial planners or provide financial planning services.

If you are involved in advising clients regarding investing or managing multiple asset class portfolios for clients, this book has been written for you even if your primary profession is as a comprehensive financial planner, investment advisor, accountant, insurance specialist, securities broker, trustee, or lawyer.

**WEALTH MANAGERS AND MONEY MANAGERS**

One of the most confusing issues for the public (and many professionals) is distinguishing between the profession of money management oriented toward managing assets for