
THE OBVIOUS SOLUTION:

CUSTOM-DESIGNED FINANCIAL
PEACE OF MIND



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**The Obvious Solution:
Custom-Designed Financial Peace of Mind**

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*The O'Donnell Group
A Wealth Planning Firm*

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I. An Introduction to Wealth Management

A. Who This Book Is for and What It Can Help You Accomplish

If “Custom-Designed Financial Peace of Mind” is an obvious solution to a problem important enough to write a short book about, then you might rightly ask:

- What exactly is the problem that is being solved?
- Who benefits from the solution to the problem?
- What exactly is the solution, and why does it work?
- And finally, if the solution is so obvious, why isn't it more widely applied?

Before we dive in and answer these questions, please consider the following:

Sometimes in life, the simplest things can make the biggest difference.

Unfortunately, regardless of how unhappy or dissatisfied we might be, we are unlikely to notice or become aware of those simple things—even if they are right in front of us—if we are saddled with years of history and inertia. Like it or not, none of us can know what we don't know, and if we don't know that different and better options exist, then at a certain point, we are likely to just stop looking for them.

The solution being presented in this book is not always easy to execute well. But it is in many respects a simple and obvious solution—one that really works—and can be stated as follows:

Affluent families can benefit tremendously from working with a true "wealth manager," that is, an individual or firm that can provide you and your family not just with personalized investment solutions, but with a process that ensures that all of the financial and financial-related aspects of your life (e.g., investment planning, tax planning, estate planning, legal and insurance planning, and charitable gift planning), sync together and work as an intelligent whole.

We hope that by the time you have finished looking through this book, this simple and obvious solution will be so clear and will make so much sense that if it applies to your situation, you will take action and move forward in implementing it. (One way to move forward is to receive a free second opinion on your situation, which we'll discuss in Chapter IV.) Our firm may or may not be the right match for you, but no doubt there is a perfect fit for you or you and your family out there. Ultimately, if this book motivates even one individual or family to move from dissatisfaction to satisfaction, from doubt to clarity, or from haphazard handling of the many elements of their financial and financial-related life to a comprehensively secure and content state of mind, then it will have accomplished its purpose.

But how can you tell, to begin with, whether the wealth management solution described here is appropriate for you and your family? First, *the problems and solutions being explored here mainly apply to individuals and families that are fairly financially affluent*, meaning those who have \$1 million or more in investable liquid assets. If you are not (yet) in that economic category, you may still gain a lot of value from parts of this book, especially Chapter II, but also parts of Chapters III, IV, and V.

Second, as for *whether the solution will likely benefit you and your family*, ask yourself whether you have any doubts at all, or experience complete financial peace of mind, with regard to both how your money is now being invested and how all your financial and financial-related affairs are being handled. In our experience, it takes a custom-designed plan by someone with an evidence-based understanding of investments as well as a big-picture but detailed understanding of the many pieces of a family's life, to provide this kind of financial peace of mind.

Put differently, ask yourself if you have any questions, qualms, or concerns about where you and your family are financially, both in the short and long run. In truth, if you have a caring and proactive wealth manager working with you, you should be able to breathe a big sigh of relief even when the unexpected happens or the financial news turns dark.

B. The True Wealth Management Formula

In the spirit of keeping things simple, we will define a “wealth manager” as someone who understands and practices, to the benefit of his or her clients, the formula for true wealth management, which is:

$$\mathbf{WM = IC + AP + RM}$$

This formula states the five main concerns of the affluent and how to address them. Written out, it stands for **W**ealth **M**anagement equals **I**nvestment **C**onsulting plus **A**dvanced **P**lanning plus **R**elationship **M**anagement. Let’s briefly go through the formula’s elements one by one.

First, Investment Consulting (IC) is the astute management of investments over time to help you and your family achieve your short- and long-term financial and financial-related goals and dreams. It requires the wealth manager you are working with to deeply understand everything about you, including your most important challenges, so he or she can design an investment plan that (a) takes your time horizons and tolerance for risk into account so that (b) it will maximize the probability that you and your family will achieve all your goals and dreams. Importantly, a wealth manager will also follow the dictates of what has been called evidence-based investing—what is both academically and pragmatically successfully demonstrated—which we’ll delve into in Chapter II.

The next element of the formula for wealth management is Advanced Planning (AP). Essentially, Advanced Planning means that all the aspects important to your long-term financial and financial-related outcomes must be carefully elucidated, thought through, and comprehensively planned for so that all these various elements work together, in sync and in harmony, for your (and your family’s) greatest benefit. Now the Advanced Planning component further breaks down into four specific areas.

$$\mathbf{AP = WE + WT + WP + CG}$$

The sub-elements of **A**dvanced **P**lanning are:

- **Wealth Enhancement** (primarily enabling you to keep more of what you earn through tax planning);
- **Wealth Transfer** (making sure that the eventual transfer of your wealth to future generations is carefully thought through and correctly executed);
- **Wealth Protection** (making sure your wealth isn't unjustly taken from you, by ensuring you have adequate insurance and ownership of your assets is properly taken care of legally); and
- **Charitable Giving** (if you have charitable intentions you wish to see implemented, we help make sure they are as impactful as possible); note that the CG part of the formula for wealth management will be discussed in Chapter IV since it folds in nicely with a discussion of your estate planning).

Put somewhat differently, Advanced Planning is all about enhancing your wealth through effective tax planning, making sure your wealth is properly transferred in such a way that your heirs are taken care of, making sure your wealth is properly protected through appropriate insurance and correct titling of assets, and, finally, making sure your charitable intentions, if any, are as impactful as possible. We will discuss these Advanced Planning elements in more detail in Chapter III.

As previously indicated, the Advanced Planning part of the formula is often the hardest for a wealth manager and his or her clients to work through. A wide variety of personal, emotional, and potentially difficult-to-think-about issues are not only likely to arise, but in fact often *have to* arise if a comprehensive and intelligent plan is to be put in place. You must therefore trust your wealth manager completely, and also feel that he or she actually cares about you and your family. We will say more about how to go about finding the right wealth manager in Chapter IV.

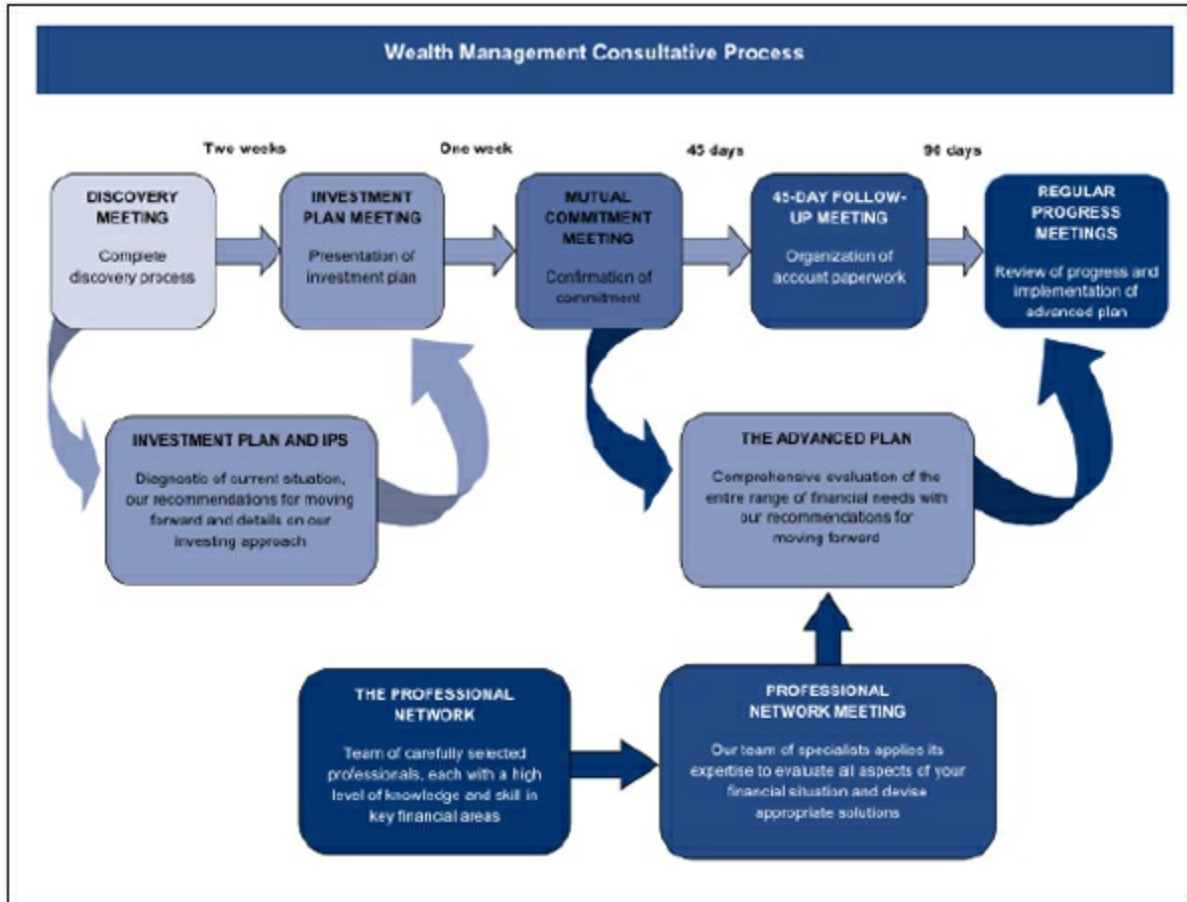
Finally, let's return to the last element of the formula for wealth management, which is **Relationship Management (RM)**. This doesn't mean a wealth manager is a social butterfly or party planner, but rather refers to his or her ability to coordinate a team of experts and professionals—including an accountant or CPA, an estate attorney, and a high-end insurance provider—on your behalf.

Why? Well, the world has become so complex that no one professional can

keep up with or have extensive expertise in all the challenges, changes, products, and solutions that might be relevant to your situation. Instead, in addition to having a firm handle on the Investment Consulting part of the formula, a wealth manager will work with a team of experts from the fields mentioned above—including those you already know and work with and would like to continue working with—to make sure that all the aspects of your wealth management plan make sense when looked at together. In fact, this comprehensive approach is one of the three hallmarks of true wealth management, as we shall now explain.

C. A Comprehensive, Consultative, Proactive Process

If you are affluent, then you probably already work with a financial advisor, and you might be wondering, “What’s different, really, about working with a wealth manager, even a ‘true wealth manager’ as defined here?” The bottom line is that a true wealth manager will not only understand all the elements of the formula for wealth management described above, but *he or she will have a proven and well-defined process in place to uncover and then move forward with your goals, your dreams, and the key challenges before you.* With such a process in place, instead of focusing on reinventing the wheel, a wealth manager can focus on bringing you maximum benefit and financial peace of mind. The wealth management process that we use at The O’Donnell Group is shown below. We’ll now turn to the three major defining characteristics of this process.



First, the process will be **comprehensive**. Anything and everything of financial and financial-related importance to you (and your family) will be taken into account and optimized. This means that at the front end, tried and true methods for uncovering what's important to you will be brought into play.

For example, at our firm, in the first discovery meeting, we will spend approximately ninety minutes walking you through a series of questions around seven major themes. This allows us to understand your values, what's important to you about money, your goals (personal, professional, and financial), the relationships and people important in your life, who your other advisors are, an understanding of your assets and liabilities, and the processes we use and how we can best work together. Then, working with the team of experts described previously, we make sure that all parts of your situation are considered together, because it's only from that holistic, comprehensive perspective that we can ensure things are optimized on your behalf. Ultimately, if something is—or might be—important to you, then a wealth manager will

have a process in place for finding out what it is, and for making sure you experience the best possible outcomes with regard to it.

Second, the process will be **consultative**. This means that a wealth manager will treat you as a responsible, intelligent, and empowered adult and colleague, and will go out of his or her way to find out how you want to work, how you want to be communicated with, and what you feel strongly about. In addition, because only so much can be accomplished in one meeting or session, the consultative process will usually unfold over a series of meetings, as follows:

- *Day 1:* At the **discovery meeting**, the wealth manager will determine your current financial situation, where you want to go, and the obstacles you face in achieving what is important to you. This meeting typically lasts ninety minutes.
- *Two Weeks Later:* At the **investment plan meeting**, the wealth manager, using the information he or she gathered at your first meeting, will present a complete diagnostic of your current financial situation and a plan for achieving your investment-related goals.
- *One Week Later:* At the **mutual commitment meeting**, assuming that the wealth manager can truly add value, you and the wealth manager may decide to work together, at which point you will now officially be a client. Essentially, you are committing to working with us, and we are committing our time and resources to helping you achieve everything that's important in your life.
- *Forty-Five Days Later:* At the **initial follow-up meeting**, the wealth manager will help you organize your new account paperwork and answer any questions you may have.
- *Ninety Days Later:* At **regular (typically quarterly) progress meetings**, the wealth manager will give you a progress report and check in with you on any important personal, professional, or financial changes in your life that might call for an adjustment to your investment plan. In addition, at the first regular progress meeting, the wealth manager will present your advanced plan—a comprehensive blueprint for addressing the advanced planning needs described above and developed in coordination with the wealth manager's network of expert professionals. At subsequent progress meetings, you and the wealth manager will decide on how to proceed with

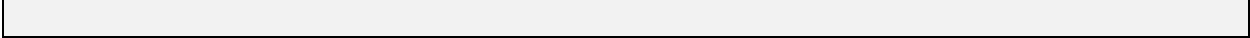
specific elements of the advanced plan. In this way, over time, every aspect of your complete financial picture will be effectively managed.

Finally, the process used by a wealth manager will be distinctly **proactive**. He or she will not only provide you with top-notch service in every way, but will be on the lookout to make sure that everything that is of importance to you is being continually scanned for and taken into account. At the end of the next chapter we will discuss how the RIA—registered independent advisor—status of many wealth managers ensures that he or she has a fiduciary obligation to you that in effect legally ensures his or her proactive stance. More important, however, a wealth manager will think of himself or herself as your personal CFO (chief financial officer), someone who takes pride, pleasure, and professional satisfaction in proactively addressing everything of importance to you and your family.

Be a 7-Percenter, Not a 93-Percenter!

If you don't experience your current financial advisor as having a comprehensive, consultative, and proactive process, well, don't worry, because you are not alone. Research reveals that only a small percentage—roughly 7 percent—of those who call themselves "wealth managers" ever look beyond the Investment Consulting part of the wealth management formula laid out earlier in this chapter. (See *Best Practices of Elite Advisors* by Patricia J. Abraham, John J. Bowen Jr., and Russ Alan Prince (CEG Worldwide, 2007).)

That means that 93 percent of those who are told they are receiving wealth management services really aren't! Even those financial advisors who do look at the big picture *rarely have a well-defined process in place* to ensure that everything of importance to you and your family is uncovered, comprehensively addressed, and optimized to sync with everything else that is going on for you. Ultimately, if you have the kind of affluence that can support and would benefit from such a comprehensive, consultative, and proactive process, yet what you are experiencing from your financial advisor is very different from this, you may want to take further action, and take advantage of our free but potentially very valuable second opinion service, as described in Chapter IV.



II. Evidence-Based Investing

A wealth of evidence shows that certain ways of going about investing reliably produce better returns and happier investors over the long run. Of course, other ways of investing—however fashionable or seemingly appealing—very rarely work out well and often are extremely harmful. As wealth managers we consciously investigate and adopt tools, strategies, and methods based on academic and economic evidence as well as the actual results of our clients. There's also a whole lot of common sense involved, which is why we do our very best to make sure our clients do not take unjustified chances, overreact to bad market news, or fail to understand that, over time, markets—and therefore investor portfolios—inevitably go up *and* down.

A great deal of hard-core academic research in economics and allied fields is involved. We are fortunate that Nobel Prize winners (such as Harry Markowitz, who with his colleagues gave us “Modern Portfolio Theory”¹), leading economists, and behavioral financial experts have for the most part figured out the “true investing science” that undergirds wealth management. In fact, the IC or Investment Consulting part of the wealth management formula described in the previous chapter is often the *least* difficult aspect of a client's situation for a wealth manager with a knowledge of evidence-based investing to fully address. Essentially, once the client's goals, dreams, time horizons, and risk tolerance are established, it usually becomes pretty clear how to proceed.

Do You Feel Lucky?

At http://www.ifa.com/articles/surprise_no_selloff_2013, Weston Wellington, Vice President at Dimensional Fund Advisors (DFA), writes:

Most of us accept the idea that predicting the future is difficult. And predicting how other investors will respond to unpredictable events is harder still. But, for some of us, the temptation to engage in such efforts is irresistible. If only we could do so, we could be so much wealthier, have the

satisfaction of outwitting other clever market participants, and make ourselves more attractive to members of the opposite sex.

Unfortunately, ALL the academic research that has been done says that we should be skeptical of our ability-or anyone else's-to do this well enough to outperform a simple diversified buy-and-hold strategy.

In this chapter we will look briefly at the science of evidence-based investing, consider the importance of constructing a globally diversified low-fee portfolio, and explain the critical need for investors to maintain their discipline and stick to their plan. We then conclude with a discussion of why it makes sense to rely on a wealth manager who is an RIA (Registered Investment Advisor) and is therefore bound to proactively take care of your interests in accordance with a broad fiduciary obligation.

A. Bottom-Line Takeaways From Evidence-Based Investing

While evidence-based investing tells us many important things, there are a few bottom-line takeaways that all investors should come to fully understand and appreciate:

- Net of fees and expenses, virtually no one can consistently beat the market's average return over time;
- “Active management”—getting in and out of stocks and other investments based on the news and various forms of prognostication—rewards brokers and money managers but generally not their clients;
- Markets are very efficient, so by the time you hear of some great news or amazing investment, it is almost always too late for you to profit from it (in fact, you will usually lose money by acting on such news);
- Diversification, as described and explained by Modern Portfolio Theory and implemented through asset allocation, is the only genuine “free lunch” in investing, and all investors should take advantage of it.

To begin with, no matter what you may have heard elsewhere, **it is extremely rare for anyone to consistently beat the market** (net of fees and expenses). As highlighted in Burton Malkiel's best seller, *A Random Walk Down Wall*

Street (first published in 1993, now in its tenth edition), the behavior of any given stock or other investment on any given day is essentially entirely random. No one—not the most famous economists or the brainiest investment bankers or the canniest hedge fund operators—has a consistent crystal ball, and no one knows what will happen next.

Consequently, what is called “active management”—making tactical decisions based on the news or economic forecasts and buying and selling stocks in response—simply does not work except for the occasional lucky practitioner over a short period of time. Given the large number of active managers out there, you would expect that half would beat the markets, but the reality is, very few ever do. In fact, given the random real-time nature of the movement of stocks, almost no one has *ever* consistently beaten the market net of fees and expenses for any significant period of time. There are winners in the world of active management: the mutual fund companies who charge fees for the privilege of investing in their funds, and the stockbrokers and others who make a commission each time their tactical recommendations result in changes to their clients’ portfolios.

Going Bananas Over Some Random Monkey Business

Rick Ferri, on Forbes.com in the Personal Finance section on 12/20/2012, writes:

What is all this monkey business? It started in 1973 when Princeton University professor Burton Malkiel claimed in his bestselling book, *A Random Walk Down Wall Street*, that "A blindfolded monkey throwing darts at a newspaper's financial pages could select a portfolio that would do just as well as one carefully selected by experts."

"Malkiel was wrong," stated Rob Arnott, CEO of Research Affiliates, while speaking at the IMN Global Indexing and ETFs conference earlier this month. "The monkeys [in our experiment] have done a much better job than both the experts and the stock market."

This doesn't surprise us. In addition to making truly random (and therefore truly diversified) picks by throwing darts, monkeys-unlike the average active mutual fund manager who charges around 1 1/4 percent-work for bananas.

If you want some proof of this, go ahead and Google a list of the best money managers or best mutual funds. Then check the previous year's listing for the same category. Inevitably, the managers and mutual funds that were at the very top stay there only a little while, and before very long they are among the bottom performers. Again, this isn't because people who are really on top of things suddenly start losing their edge; instead, it's because of how the world of investments works—randomly—without any way of participants knowing ahead of time how things will turn out.

But what if you happen to have heard some amazing financial news from CNN, or from your friend who works in the oil industry, or from your nephew in Silicon Valley who has identified the Next Big Thing? Well, one thing we know about markets is that they are *highly efficient*, which means that by the time you have heard about something wonderful, so have large numbers of other people. If you are told about a company that is about to introduce a breakthrough and see that its stock has already gone sky-high, it means that the breakthrough has already been taken into account by institutional and other investors, and if you put your money in, it is likely to be at or near the high. In other words, given the highly efficient nature of the markets, you are likely to *lose* money on the investment.

The final bottom-line takeaway worth emblazoning in your mind is the critical importance of diversification, which comes to us through Modern Portfolio Theory. Essentially, there are two types of risks that come from investing. The first type, known as “unsystematic risk,” comes from a company experiencing bad news, bad performance, bad luck, or bankruptcy. The other is called “systematic risk,” which is the kind of risk that all investments are generally subject to, including risk attached to events such as an economic crisis, a war, a global currency crisis, and so on.

While you can't do anything about systematic risk, Modern Portfolio Theory shows that by increasing the number of investments you own, you can diversify

away the unsystematic risk in your investment portfolio, which can also be understood as reducing the volatility of your investments. For example, if you invest in only five companies and one of those companies takes a big hit because of an unexpected product failure or criminal investigation, your overall portfolio would suffer terribly. But if you own 500 companies, such bad news affecting any given company—or even any given sector—will have far less impact on you. (One in five investments precipitously tanking is much worse than one in 500 investments doing so.)

Diversification is often said to be the only “free lunch” in investing. Why? Having a portfolio with relatively few investments in it means you are taking on unnecessary unsystematic risk, and since you can easily diversify away that risk, there is no extra reward for taking it on. Why would you hold onto something you don’t need or want if you are not getting rewarded for it and there is an easy way to deal with it? There are, of course, many complexities to Modern Portfolio Theory—things you may have heard of such as “the efficient frontier” and ways of mathematically creating the least risky and most advantageous portfolio by combining different types of assets—but for our purposes, just remember the critical importance of widely diversifying and allocating your assets across many different industries, sectors, and, as we shall soon see, countries.

B. Constructing a Globally Diversified Low-Fee Portfolio

There are no crystal balls in the science of investing. There are, however, better and worse ways of doing things. Given how much is *not* under our control, at our firm we feel it is absolutely critical to do our very best to control what we *can* control, including:

1. Keeping investment fees low;
2. Diversifying as much as possible;
3. Keeping the discipline; and
4. Minimizing taxes.

Investment fees can be kept as low as possible in two ways. First, by working with a wealth manager who is “fee only” and not transaction-based or fee-based, you will pay a small but reasonable fee based on a percentage of your

total assets under management every year. This takes away the incentive of a transaction-based financial advisor to actively manage or change your portfolio around willy-nilly just to generate commissions, and lets you know ahead of time what you will be paying every year. When taking into account the kind of comprehensive services laid out in the previously described formula for wealth management, this is a cost-effective way of approaching the entirety of what's financially important to you and your family.

Second, investment fees can be kept low by investing through companies such as DFA (Dimensional Fund Advisors) or perhaps Vanguard. These companies provide a variety of investment fund opportunities that are not only widely diversified, but that embody a much lower fee structure than that of other funds. DFA's offerings, in particular, are explicitly designed to take advantage of the science of investing, and consequently DFA has a long track record of providing desirable returns with a low fee structure.

There's No Such Thing as a Free Lunch

As brokers working for a big national firm, my brother Mike and I had been flown to a Wall Street conference in New York City where we were wined and dined by product "wholesalers." The wholesalers worked for big mutual funds, and it was their job to get us to sell *their* products to *our* clients.

At dinner, eating a perfect steak and drinking a \$200 bottle of wine, I found myself thinking about a trusted friend who had just returned from an elite investors group called Tiger 21. He told me their advice to him was to invest in nothing but DFA and Vanguard at worst. I'd never heard of DFA, so I gave them a call, and was told that we couldn't buy any of their funds until we went through their two-year "approval" process! They let me know that we could fly down and attend their next conference in a couple of months and begin their training...at *our* expense. At *our* expense? That seemed crazy, especially given the quality of the fine food and wine that I was consuming at that moment, for free. *That's when it hit me.* Everybody knows that "There's no such thing as a free lunch," and that meant that *somebody* was paying for our lunch. "Mike," I said to my brother, "How much do you think this conference costs?" "Well," he said,

"there are lots of attendees, they flew us all out here and put us up at a five-star hotel, and they're treating us very well, so maybe a half million dollars." "That's about right," I said, "so let me ask you a question: where did all that money come from?" "From the wholesalers," he said, "and now I suppose you're going to ask me where *they* got the money from...and the answer has to be from the investors who bought the funds they are promoting. Their investors-including our clients-are paying for our lunch!"

First chance we got, we began analyzing the fees and expense ratios of most of the big funds and realized they were much more expensive than the 10 to 25 basis points charged by DFA. After going through the DFA approval process and learning about their investment philosophy, we both agreed that it was our clients we ultimately had to take care of and that it made no sense for them to pay all that money in the form of higher fees when equally good, if not better, widely diversified low-fee funds were otherwise available. Second, investment fees can be kept low by investing through companies such as DFA (Dimensional Fund Advisors) or perhaps Vanguard. These companies provide a variety of investment fund opportunities that are not only widely diversified, but that embody a much lower fee structure than that of other funds. DFA's offerings, in particular, are explicitly designed to take advantage of the science of investing, and consequently DFA has a long track record of providing desirable returns with a low fee structure.

The second controllable to control is your portfolio's diversification. Again, diversification is the only true free lunch in investing because it lowers your overall risk by smoothing out your portfolio's potential volatility. Now, to be properly diversified means not only having many stocks from different industries and sectors in your portfolio, but having stocks from many different countries as well.² Just as any given company in any given industry or sector is more likely to take a huge hit than are all the companies in that industry or sector, the stocks from any given country or economy are more likely to tank in tandem with each other than are stocks from all around the globe. To have a truly globally diversified portfolio, you should own over 10,000 stocks and be invested in more than forty countries, which can be achieved at a relatively

low cost through DFA or Vanguard funds.

The third thing that can and must be controlled is taxes, and we will discuss wealth enhancement through minimizing taxes in Chapter III. The fourth and final controllable is behavior—the behavior of investors and clients who are often tempted to do the wrong thing at the wrong time for the wrong reason—a subject to which we will now turn.

C. Expectations and Keeping the Discipline

A Bear of a Problem

If you've ever been camping or hiking in a wilderness area, you have no doubt heard the advice that if you do happen to come face-to-face with a bear in the woods, the worst thing you can do is to run away, as the bear—who is faster than you—will perceive you as prey. Instead, you are supposed to stand there, raise your arms and your coat high if you have one, and then slowly but surely back off as you speak in soft, confident, calming tones.

In reality, however, most of us who would encounter a bear are likely to run! Despite what we've heard, we're not just going to stand there and let a bear eat us. Well, when the market is bearish—even if you understand that those who sell in fear tend to lose quite a bit—you may very well want to dump your investments like crazy! Who is the person most likely to keep you from making this kind of mistake? It's a wealth manager whom you trust, who has your interests at heart, who has a robust fiduciary obligation to you, and who has previously discussed just this scenario with you!

Warren Buffett once said that “Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ....Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble investing.” These urges, and how to work with them, are the province of the academic field of behavioral finance. Once again, then, a wealth

manager will take advantage of validated academic research as well as personal experience and common sense in working with his or her clients to help ensure the best possible long-term outcomes.

The problem boils down to this: investors tend to react emotionally to the movements of the markets, making abrupt changes to their portfolio in ways that cost money, incur taxes, and leave them unable to take advantage of the market's long-term down and up cycles. Right after the Great Recession of 2008-2009, there was a lot of discussion about how the long-term returns for U.S. stocks were no longer going to be at the 7-10% rate they had been for many decades (depending on how you calculate it and how far back you go), but since then the markets have climbed back to and beyond their former heights. But what happened for far too many investors was that they took themselves out of the equities markets after things went down and were too late in getting back in, and they ended up missing most of the upside appreciation. Similarly, there are many individuals who wait for a "dip" in the markets before investing additional monies, but the "right dip" never seems to come along. And of course, as previously discussed, there are those who rush in to buy hot stocks and new issues after the "great news" has come along far too late to help them.

To help prevent erratic behavior that costs clients dearly, as wealth managers we consistently do three things:

- First, we have a set discipline as to what we invest and how long we hold it, based on everything else we know about the client.
- Second, we make sure that the client has realistic expectations ahead of time. That means understanding that the markets will go up...and down...and up...and down...and up, and that the best way to guarantee strong long-term returns is to aim for singles and doubles, not home runs, by investing in low-cost, globally diversified funds such as those offered by DFA. Put differently, we help our clients realize that even with a widely diversified portfolio, volatility is part of the process, and in some years their portfolios will inevitably lose money.
- Third and finally, we develop a level of trust and understanding, and regular consultative communications, between our clients and ourselves so that even if the world seems to be falling apart, they know we are thinking about them, have their interests in mind, and are doing the right

thing by sticking to our agreed-upon plan.

A recent wonderful book, Daniel Kahneman's *Thinking Fast and Slow* (2011), is highly recommended for anyone who wants to get a better understanding of why, as humans, we are often tempted to make the wrong short-term decisions. Even if you read and fully grasp this and similar works, keep in mind that the best strategy to avoid making erratic short-term investment decisions is to work with a wealth manager whom you trust, and ideally who is bound by a broad, proactive fiduciary standard, as will now be explained.

D. Follow the Money: The Benefits of Working With a Fiduciary RIA

Not everyone who is licensed to sell you investments is bound by the same level of duty and care. A Registered Investment Advisor, according to the Securities Act of 1940, is bound by a fiduciary duty to act in your best interests. That is a much more robust standard than for most registered representatives and stockbrokers who are bound by a mere "suitability standard." Consider what Investopedia.com has to say about this:

Investment advisors are bound to a fiduciary standard that was established as part of the Investment Advisors Act of 1940. The act is pretty specific in defining what a fiduciary means, and it stipulates that **an advisor must place his or her interests below that of the client**. It consists of a **duty of loyalty and care, and simply means that the advisor must act in the best interest of his or her client**....It also means that the advisor must do his or her best to make sure investment advice is made using accurate and complete information, or basically, that the analysis is thorough and as accurate as possible. Avoiding conflicts of interest is important when acting as a fiduciary, and it means that an advisor must disclose any potential conflicts to placing the client's interests ahead of the advisor's. Additionally, the advisor needs to place trades under a "best execution" standard, meaning he or she must strive to trade securities with the best combination of low cost and efficient execution...

Broker-dealers only have to fulfill a suitability obligation, which is defined as making recommendations that are consistent with the best

interests of the underlying customer. Broker-dealers are regulated by the Financial Industry Regulatory Authority (FINRA) under standards that require them to make suitable recommendations to their clients. Instead of having to place his or her interests below that of the client, the suitability standard only details that the broker-dealer has to reasonably believe that any recommendations made are suitable for clients....A key distinction in terms of loyalty is also important, in that a broker's duty is to the broker-dealer he or she works for, not necessarily the client served.

Ask yourself this, then: wouldn't you rather trust your long-term financial situation to someone who is bound by law to offer you a higher duty of care and loyalty, and who must place his or her interests below yours? This is why, in part, a wealth manager will spend so much time getting to know you and your family, as well as what your long-term goals, dreams, and timetable look like. It also helps explain why a wealth manager will provide you the kind of custom-designed forward-thinking analysis and recommendations that can help you achieve financial peace of mind.

Put differently, if you rely on a non-RIA stockbroker who works at a firm, you are technically the firm's client, and the stockbroker, who works for the firm, owes you only a suitability standard of care. But if you work with an RIA, you are that RIA's client, and he or she is bound by a fiduciary obligation that goes far beyond the suitability standard. And if that RIA happens to also understand and practice all the tenets of true wealth management, then you are far ahead of the game.

III: Advanced Planning: Wealth Enhancement, Transfer, Protection & Gifting

In review, the basic formula for wealth management is

$$\mathbf{WM = IC + AP + RM}$$

or **W**ealth **M**anagement equals **I**nvestment **C**onsulting plus **A**dvanced **P**lanning plus **R**elationship **M**anagement. Advanced Planning further breaks down as follows:

$$\mathbf{AP = WE + WT + WP + CG}$$

That is, AP equals **W**ealth **E**nhancement plus **W**ealth **T**ransfer plus **W**ealth **P**rotection plus **C**haritable **G**ifting. Many people first think about turning to a financial professional for help with the IC element—everyone wants a decent return on their investments. However, optimizing the IC element can be relatively simple and easy to achieve—following the tenets of evidence-based investing, as described in Chapter II—compared with the many personal, individualized, and critically important elements that Advanced Planning addresses.

To give you an idea of what is involved here, this chapter will go through the four Advanced Planning areas at a very high level. Ultimately, though, everyone should consider working with a qualified wealth manager to meticulously investigate and address each of these areas with regard to their own situation.

A. Wealth Enhancement: Keeping More of What You Make by Minimizing Taxes

Mitigating the effect of income and other taxes is a concern that nearly

everyone shares. While most people are happy to pay their fair share of taxes, a competent wealth manager will endeavor to make sure that you pay *only* your fair share.

Working in tandem³ with a CPA or accountant of your choosing (or someone who the wealth manager brings to the table), a wealth manager will carefully review the big picture of your financial life with an eye to minimizing taxes. All your investments and accounts, all your real estate, all your business concerns, and so on, will be reviewed and optimized to save on taxes wherever possible. Importantly, your big-picture tax situation bears directly on what the proper investment portfolio for you will look like.

In consultation with your wealth manager, then, consider the following sorts of questions:

- What's the proper investment portfolio for you given your tax situation and what you are doing in real estate and with your business?
- Is your business set up properly in the first place to mitigate income taxes?
- If you have multiple business entities with multiple accounts, are things set up to take maximum advantage of capital expenditures and other savings?
- Are you taking proper advantage of all potential personal and business deductions?

Appreciating Depreciation: A Proactive Success Story

In early September of last year, at a regular quarterly progress meeting, a real estate development client of ours let us know of his intentions to invest \$300,000 in one of his tax-favored urban infill development buildings late the following year. After meeting, given that we knew our client had no cash flow problems, we wondered to ourselves whether it might make sense for him to invest the resources in the current year. There would be an additional cost of a few thousand dollars to expedite the pulling of permits, but we were curious as to whether that would be offset by any potential tax benefits. We took the initiative and reached out to our client's accountant, and asked whether it would make sense to make the capital expenditure this year. Sure enough, she determined that the depreciation rules for these kinds of projects were changing significantly,

and that by completing all work by December 31 of the current year, our mutual client would save \$75,000 in taxes.

We called the client back a week later and told him that we had spoken with his accountant, and that while it would cost him \$4,000 more to get it done this year, it would save him \$75,000, for a net gain of \$71,000. A no-brainer! And a win-win-win for the client, for his accountant, and for us. Put simply, we were able to work together as a coordinated team to have a meaningful impact on our client's business. That's the real beauty of having a wealth manager act as your personal CFO. Unlike other professionals who are compensated on an hourly project basis, we receive a small but reasonable yearly fee based on a percentage of your total assets under management. Therefore, we are able to—and in our minds, are expected to—think in a big-picture, proactive way that transcends professional specialties. We can take the initiative on any given issue or question that comes to our attention, and then coordinate the efforts of your other professionals if their expertise is or may be required.

For many people, a wealth manager will fill a crucial proactive role—especially in the various Advanced Planning areas—that other professionals often can't or don't fill. As expressed in the “Appreciating Depreciation” box on the previous page, since a wealth manager is compensated differently—you pay a small but reasonable fee based on a percentage of your total assets under management every year—it is easier for him or her to have a big-picture, macro-level, proactive focus on the entirety of your personal situation. In addition, then, to helping you with regular deadlines and crises, as other professionals do, a wealth manager can more easily go beyond making sure everything is basically OK to looking at how to make things better in the long run.

A wealth manager sits next to you in the driver's seat of your life and can help you purposefully steer your financial situation in a more optimal direction. Suggestions and ideas will be generated by the wealth manager for your accounting, legal, insurance, and other professional service providers to review. With these people working together as a team, your overall tax burden may be diminished. While there are no guarantees that working with a wealth

manager will significantly lower your tax burden, it can be very helpful to have someone sitting in the driver's seat looking out for tax mitigation potentials in connection with all your other financial, business, and investment concerns and involvements.

B. Wealth Transfer: Taking Care of Family and Heirs for the Long Run

Wealth Transfer refers to the proper, orderly, and tax-efficient transfer of your estate to your heirs upon your death. Most people, even those with sizable estates, have a boilerplate trust set up at best. If more assets are involved, more than one trust might be created, in an effort to create considerable tax savings for the heirs.

As always, however, the devil is in the details. To make sure the right testamentary documents are drafted and the optimal number of trusts and other vehicles are created, there has to be someone present who understands all the family's details, from soup to nuts. A wealth manager, then, will sit down with clients—especially older ones—to walk them through the many possible paths that life might take. He or she will then help determine the best way to structure things, taking into account as many contingencies as possible. People need and want to take care of their heirs, yet they also have to consider what their own needs are now and in the future as they get older and before they die.

For example, what if there is an autistic child in the family? Or what if one spouse has some kind of long-term health condition that will inevitably become a substantial burden on the other spouse? Looking at the big picture, making sure there is enough money while the parents are alive and yet maximizing the size of the estate, can be done only with the help of someone who is proactively considering everything of importance.

Questions and issues relating to long-term health care, long-term housing, the mix and availability of state and federal government benefits, and all the nuances of retirement planning generally have to be evaluated to ensure that eyes-wide-open solutions are put in place. In some cases—consider the spouse with the long-term health condition—having certain types of assets on hand will disqualify the spouse from receiving certain types of benefits, either before or after the other spouse dies.

An allied issue concerns the successful transition of wealth to heirs. In many cases there is family infighting, or an heir given too much wealth too quickly will act in profligate and destructive ways. Heirs need to inherit in such a way that they are most likely to succeed in life, and working with a wealth manager who is aware of this mix of issues will make it much more likely that when you (and your spouse, if you have one) do pass on, things will happen the way you envisioned they would.

Things can be particularly tricky for families of substantial wealth, where multiple homes, investment accounts, and other assets are involved. No one likes to think about all these kinds of issues ahead of time, but the best way to prevent animosity between heirs and to ensure a proper and tax-efficient wealth transfer upon death is to do substantial holistic planning ahead of time.

C. Wealth Protection: Making Sure Your Assets Aren't Unjustly Taken

Wealth Protection is all about finding the holes and weaknesses in your financial life and addressing them—usually but not always with proper insurance—before something happens. Basically, the more money you have, the more likely you are to be sued or to have someone come and assert a claim on your assets. When people know you have liquid wealth—that you could write a check to make a problem go away—they are more likely to generate problems and issues that you may have to address.

Now, while many people are aware that as they become wealthier they become more of a target, it's also true that most people are significantly underinsured in a number of critical areas. People don't see the risks they are exposed to because they don't spend a lot of time thinking about these risks, which is why a wealth manager's role here is to sit down with his or her team and say, "What are the gaps here? What is missing? Where are our clients exposed? Are all our clients' assets properly titled? Can our clients move from recourse to non-recourse debt on this property? Has anyone thoroughly reviewed the totality of our clients' insurance policies in the last ten years?"

Even if the chances of something bad happening are one in a million, it's the wealth manager's job to make sure that chance is thought through ahead of time and protected against if necessary. For example, many people say, "Hey, I've

got a million-dollar umbrella liability policy, so no problem.” Well, that might have been fine for 1999, but a million dollars isn’t what it used to be. If you have a net worth of \$10 million and only a million-dollar policy, you could be in serious trouble, especially considering that a \$5 million or \$10 million policy usually won’t cost dramatically more.

Related areas involve how your assets are titled and how your business ventures are set up. In the initial discovery meeting—see Chapter I—a wealth manager will delve into your entire picture, and if anything is awry, will alert you and make sure that in combination with other service professionals, things are taken care of ahead of time. For example, suppose a spouse has a successful small business—a hobby that took off but that could potentially involve liability if someone misuses the product being sold. Well, a fix for that might be to create an LLC for the spouse’s business, which will provide at least a partial liability shield. And, of course, more proper insurance if necessary might be purchased.

It’s always easier for someone from the outside—such as a well-informed wealth manager—to see the blind spots and put mechanisms in place to prevent unwanted outcomes. Yes, there are “black swans” in life that will come out of nowhere, but there are also many eventualities that can be predicted and prepared for based on a thorough holistic review of not just where someone or a family is in life right now, but where they are heading and hope to arrive. With the help of a proactive wealth manager, you can negate, transfer, or insure against risks of all kinds in a cost-effective and sensible manner.

D. Optimizing Your Charitable Intentions and Legacy

As they gather wealth and get older, many people find themselves thinking about their charitable intentions and the philanthropic legacy, if any, they want to leave to the world. Starting in the initial discovery meeting—see Chapter I—a wealth manager will likely inquire into your general charitable impulses, and then begin looking for the best, most effective, and most sensible ways for you to implement your short- and long-term giving, that is, the scope and quality of your donations now and what you want to happen after you die. Again, while most people don’t like contemplating their own demise, doing so

ahead of time allows for more careful planning and facilitates better outcomes all around.

Importantly, many people who do have charitable intentions are eager to give in as effective and impactful a way as possible. And for those who wish to make a sizable real-time gift, there may be better ways than simply writing a check. For example, if you have some stock, let's say Intel, that you purchased at a low price and that has appreciated to be worth \$100,000, you may be able to give that stock to a charitable organization and not have to pay capital gains on your investment. Or if you want to sponsor a table at a fundraising dinner, you might be able to give just a few shares of that stock, which originally cost you \$25 and now is worth \$2,000, instead of writing a check for \$2,000. You still end up getting a tax deduction, but when the charitable organization sells the stock, it will be able to do so without paying the capital gains tax.

Not everyone is philanthropically or charitably inclined, and some people prefer to pass their entire estate to family members or friends. However, if you are philanthropically or charitably inclined, a wealth manager with a big-picture, holistic perspective can help you make your short- and long-term gifting as impactful as possible. This might look like the charitable remainder trust, or setting up a family foundation to support a specific issue. By determining what incomes you desire, a wealth manager can help you make your giving as sensible, tax efficient, and effective as possible.

IV: Next Steps: A Free Second Opinion, the Right Wealth Manager

Some wealth management firms offer qualified individuals and families a free second opinion service. At The O'Donnell Group, we approach the initial second opinion meeting in a way that is very similar to how we approach the initial discovery meeting with any new potential client (as described in Chapter I.C). We will ask you to bring in your most current set of investment, brokerage, and banking statements, along with some other basic information (a list of your real estate holdings and other major assets, your insurance policies, and so on) and then have an open dialogue in which we strive to learn about your values and goals. If it makes sense after the discovery meeting, we'll continue on through the next two steps in our process, including the investment plan meeting and the mutual commitment meeting.

A. What You Will Learn From Our Valuable, Free Second Opinion Service

By the end of the initial second opinion discovery meeting, or shortly afterward, we will tell you whether we feel we are likely to be able to add substantial value to your overall financial situation and, if so, we'll ask you if you want to schedule the next meeting in our process. More specifically, based on the second opinion meeting, we will communicate to you one of three outcomes:

1. **Everything is fine, so stay the course completely or make some small changes.** In some cases we determine that an individual's or family's current financial advisor is doing a great job, that everything looks good financially, and there is really no reason to upset the apple cart. Basically, if what you have going on is working well, it would likely be a mistake to change things, and we never hesitate to give this evaluation when it is appropriate. We might, however, suggest certain small changes that would improve your situation and that you should probably discuss with your current financial advisor or wealth manager.
2. **Everything is *not* fine, but our firm isn't a good fit.** Sometimes we determine that things are really *not* going just fine, but we are aware, for

any number of reasons, that our firm wouldn't be a good fit. Since we can work with only a limited number of clients, we are happy to make a referral to another financial advisor or wealth manager that we think *would* be an excellent fit.

- 3. Everything is *not* fine, our firm may be a good fit, so let's explore further.** If our sense is that your situation is not what it should be, and that our firm would be a good fit for you, we will recommend some next steps including scheduling a follow-up meeting. There is never any pressure to make a commitment or move around any assets before you are completely ready to do so.

B. A Little Time for a Lot of Peace of Mind

If, following our second opinion meeting, the outcome is the first one described above—that there is really no need for you to make any major changes—then you can set your mind at ease. Alternatively, if it seems that you really should make some significant changes to benefit yourself and your family, then you can move in that direction as well. In either case—whether you find out that you are already on track or whether you find yourself moving in a new and better direction—you will have taken a decisive step toward achieving a better and more fulfilling long-term financial future, and you will have gained some substantial peace of mind.

Basically, regardless of which of the three above-described outcomes is reached, you will be exchanging a few hours of your time for a substantial gain in peace of mind. Given how priceless peace of mind is, that is indeed a very good return on investment.

C. Finding the Right Wealth Manager

Shredder Late Than Never: Another Obvious Solution

Have you heard about the eight-year-old boy who, wherever he went, shredded every piece of paper he could find into little bits?

Naturally, quite concerned, his parents took him to a wide variety of doctors to find a way to stop his shredding behavior. Finally, they took him to a highly regarded psychologist who, after just a few minutes, turned to the boy and said, "Hey, kid, if you stop tearing up every piece of paper you find, your parents will stop dragging you to all these doctors."

The boy turned to his parents and said, "Really? Why didn't you just tell me that in the first place?" The parents were simply too close in to try the obvious solution of just asking their son to stop what he was doing.

Sometimes, the most obvious solutions really can make a world of positive difference. In many cases, affluent individuals and families know that they probably aren't in the right relationship with a financial advisor or wealth manager, yet they are reluctant to do anything about it. This is understandable. Perhaps their current financial advisor is a family friend, or perhaps they are just unsure about making changes, or perhaps they are afraid to find out that they are not as well situated as they thought they were or should be. Still, action must be taken.

Suppose you have a nagging feeling that you aren't in the right relationship with the right wealth manager. Yes, you meet with him or her a couple of times a year and go over your performance numbers, which are OK, but deep down you suspect that your experience with your primary financial advisor should be bigger, deeper, and more satisfying than this—something that delivers you custom-designed financial peace of mind. If this is your situation, then you may very well want to find a wealth manager who offers a free second opinion service, or otherwise just make it a priority to begin an exploratory process to find someone you feel substantially better about.

What you are really looking for, ultimately, is someone with whom you "click." We've all had that experience in life, when even though we're meeting someone for the first time, we have an "Aha!" moment that things feel right and that this is a relationship worth pursuing. Whether or not you click with The O'Donnell Group, what we want for you more than anything is for you to find a wealth manager that you do feel great about. Yes, it may take some work and a little bit of time for you to find an individual or firm that you click with, but once you do, you will realize how having a personal CFO who proactively

delivers you high-quality wealth management services is a tremendous help in accomplishing all that's important to you and your family, both now and in the long run.

V. About the Firm and the Authors

Growing up in Chico, California, in a divorced family of average means, we (Mike and Ryan O'Donnell) didn't know what it was like to be or live wealthy, much less how to get there. But in our early teens we started playing golf, and at the golf course were soon exposed to many individuals and families of significant wealth.

One day a gentlemen came up to us and asked a very odd question: "What are you doing for your 'little old man'?" Puzzled, we asked him what he was talking about. He said that if you want to be successful in life, you always have to be doing something for your "little old man." And, he said with a wise nod, that the "little old man" wasn't just us at 90, but also us at 30, 50, and 70. He further explained that you always have to be doing something to make progress toward your—and your "little old man's"—long-term goals, financial and otherwise, to most successfully experience every stage of life.

In 2005, while we were both working for a large investment firm, we formed The O'Donnell Group. In 2009, after an amicable split from the investment firm, we formed our own independent firm, as we knew that was truly the only way to offer the unbiased advice—the custom-designed financial peace of mind—that our clients needed and deserved. At The O'Donnell Group, then, our goal is to help all of our clients improve and provide for their "little old man." We do this by serving as our clients' personal CFOs and addressing their five biggest concerns:

- Preserving their wealth;
- Mitigating their taxes;
- Taking care of their heirs;
- Ensuring their assets aren't unjustly taken; and
- To the extent that our clients have charitable intentions, helping them make their gifts more impactful.

As brothers, we have stuck together our entire lives. Upon leaving Chico, we both attended and graduated from the University of California, Davis, and each earned a B.S. degree in agricultural and managerial economics. At Davis we were both scholarship golfers, and golf has continued to be a major theme and

a productive, enjoyable hobby for both of us.

As this book is being written, our Registered Investment Advisory firm oversees nearly \$100,000,000 in client assets, and we are proud to say that our highest allegiance is always to our clients' needs, interests, and greatest welfare. That is, we always put our clients' interests first, not only because as RIAs we are legally obliged to do so, but because it is the right thing to do and, in our experience, the only way to reliably deliver world-class wealth management services to those who have entrusted us with the entirety of their financial lives.

¹Modern Portfolio Theory was developed at the University of Chicago by Harry Markowitz and Merton Miller, and later expanded by Stanford professor William Sharpe. All three subsequently won the Nobel Prize in Economic Sciences for their contribution to investment methodology.

²Another type of diversification is the inclusion of bonds in a portfolio, which lowers the overall volatility and therefore risk of the portfolio, but also comes at a cost in terms of lowering the potential upside of the portfolio's return.

³As mentioned in Chapter I under the "Relationship Management" aspect of the wealth management formula, smart wealth managers know that to give their clients the best advice, they absolutely need to rely on the expertise of other professionals. To this end, wealth managers should have in place an expert team whose members they regularly consult with to get answers to specific client questions and concerns. In fact, as part of their regular process, the best wealth managers will regularly meet with their full expert team—attorneys (possibly tax and estate), CPA or accountant, insurance agent, and possibly other professionals—to discuss and strategize both current events and specific clients' issues that may have arisen.

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